IN THE

Supreme Court of the United States

October Term, 1978
No. 78-616

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,
Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,
Appellees.

On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT.

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On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT.

Southern California Edison Company ("Appellant") appeals from orders of the Supreme Court of the State of California entered on July 19, 1978, denying petitions for rehearing of that Court's decisions filed on June 22, 1978, denying petitions for writs of review.[1]

[1]Under California law decisions of the California Supreme Court denying petitions for writs of review have been considered to be rulings on the merits. *People v. Western Airlines, Inc.*, 42 Cal.2d 621, 630, 268 P.2d 723, 728 (1954).

Those decisions upheld the related Decision Nos. 86794 and 87828 dated December 21, 1976, and September 7, 1977, respectively, of the Public Utilities Commission of the State of California (the "Commission"). Notice of appeal was filed on October 16, 1978. Appellant submits this statement to show that the Supreme Court of the United States has jurisdiction of the appeal and should exercise its jurisdiction to determine the substantial federal questions presented.

Opinion Below.

The decisions of the California Supreme Court of June 22, 1978, are reported at 21 Cal. 3d Official Advance Sheets No. 19 (Minutes, p. 2), and the orders denying rehearing are reported at 22 Cal. 3d Official Advance Sheets No. 22 (Minutes, p. 1). Decision Nos. 86794 and 87828 of the Public Utilities Commission are not officially reported. A copy of each of the foregoing, together with a copy of the notices of appeal, are included in the Appendix.

In addition, the Appendix includes Appellant's Petitions for Rehearing before the Commission, the Commission's decisions denying rehearing, Appellant's Petitions for Writ of Review in the California Supreme Court, Appellant's Reply Brief, and Appellant's Petitions for Rehearing before the California Supreme Court. These documents are included to show that the Appellant timely raised the constitutional issues that are the subject matter of this appeal. Finally, also included in the Appendix are copies of the Internal Revenue Service rulings relating to these matters and Commission Decision No. 84568, dated June 17, 1975, the significance of which will become apparent in the Statement of the Case below.

Jurisdiction.

This appeal is brought to review a final judgment of the California Supreme Court upholding these two integrally related rate decisions of the Commission (Decision Nos. 86794 and 87828) involving the Appellant's rate case filed on June 7, 1974, with the Commission (Application No. 54946). Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(2) (1970). The following decisions hold that Commission orders such as Decision Nos. 86794 and 87828 are "statutes" within the purview of 28 U.S.C. § 1257 (2): *Atchison, Topeka & Santa Fe Railway v. Public Utilities Commission*, 346 U.S. 346, 348 (1953); *Bluefield Waterworks & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 683 (1923); *Lake Erie & Western Railroad Co. v. State Public Utilities Commission*, 249 U.S. 422, 424 (1919).

The Supreme Court of California is the highest court of that state. The validity of each of these integrally related Commission decisions in Appellant's rate case was drawn into question in the California Supreme Court on the ground of being repugnant to the Constitution of the United States, and the California Supreme Court affirmed such statute's validity. Appellant attacked the lawfulness thereof in its Petitions for Rehearing before the Public Utilities Commission, and in its Petition for Writ of Review and thereby timely raised such issues for consideration by the Commission and by the California Supreme Court. Cal. Pub. Util. Code § 1732 (West 1975); *Southern Pacific Transportation Co. v. Public Utilities Commission*, 18 Cal. 3d 308, 311-12 fn. 2, 556 P.2d 289, 290-91 fn. 2, 134 Cal.Rptr. 189, 190-91 fn. 2 (1976).

If for any reason appeal is not considered the proper mode of review, Appellant requests that the papers upon which this appeal is taken be regarded and acted upon as a petition for writ of certiorari pursuant to 28 U.S.C. §§ 1257(3) (1970).

Statutes Involved.

The statutes which are the subject of this appeal are the Commission's decision of December 21, 1976, as clarified and affirmed by its decision of September 7, 1977, namely Commission Decision Nos. 86794 and 87828 dated December 21, 1976, and September 7, 1977, respectively, included in the Appendix. The entire decisions are lengthy and for that reason are not set forth here in full. The particular portions of the conclusions in the Decisions involved in this case are as follows:

1. "This return on capital [the allowed rate of return of 8.8%] is the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison." (Dec. No. 86794, p. 23; Appendix p. 21.)
2. "In either case [referring to the IRS information letters to the City of Dallas and New Mexico Public Service Commission—Appendix pp. 296 and 301, respectively] the inclusion of unamortized ITC in common equity at a return on equity less than that applied to the common shareholder's equity rate would dilute the indicated revenue requirement relative to such a requirement exclusive of the unamortized ITC. It is just such an effect the restrictions were intended to contravene. Such restrictions, however, are completely inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure. The unamortized ITC does, however, serve as a source of internal financing and will, therefore, eventually find its way into rate base in the form of capital additions." (Dec. No. 87828, pp. 12 and 13; Appendix pp. 126 and 127).
3. "The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable rate of return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975." (Dec. No. 87828, p. 19; Appendix p. 134).
4. "It is ordered that Decision No. 86794 is affirmed." (Dec. No. 87828, p. 20; Appendix p. 135).

Questions Presented.

1. Do decisions of the United States Supreme Court, including *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Company v. West Virginia Public Service Commission*, 262 U.S. 679 (1923), which were relied upon by the Commission, *preclude* a state regulatory commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation?

2. Whether a state regulatory commission, which has ordered utility rates designed to produce only the minimum revenue (return) required by law and which,

in so doing, has arbitrarily and unjustly disregarded certain costs and assumed, contrary to existing federal precedential rulings, the existence of a tax credit (without which the rates would produce less than the minimum return required by law), has violated the rights of the utility and its shareholders under the federal constitution by depriving them of property without due process of law and by denying an opportunity to earn a reasonable return. (U.S. Const. amend. XIV.)

Statement of the Case.

A. Background Proceedings.

Appellant is a public utility engaged in the production, transmission and distribution of electric energy. Its retail rates are regulated by the Commission. The Decision of which Appellant seeks review arose in the following manner:

1. On June 7, 1974, Appellant filed Application No. 54946 with the Commission requesting authority to increase its rates applicable to retail electric utility service in the State of California by an amount which would produce an estimated increase in revenues based upon test year 1976 of approximately $339 million.

2. On May 13, 1975, the Commission instituted an investigation regarding the investment credit provisions of the Tax Reduction Act of 1975[2] (on less than 10 days' notice because the utilities' election under the Act had to be made by June 26, 1975) and then on June 17, 1975, ordered the investigation discontinued because the Commission was not able to agree on a result.[3]

[2]P.L. 94-12.

[3]Case No. 9915, Dec. No. 84568; Appendix p. 260.

3. On June 25, 1975, Appellant elected Option No. 2, ratable flow-through[4] of the increase in ITC benefits under the Tax Reduction Act of 1975.

4. After full public hearings in connection with Application No. 54946, the Commission on December 21, 1976, issued Decision No. 86794 which (together with the partial general rate increase authorized December 30, 1975, by the Commission as an initial phase but not as final disposition of the matter—Decision No. 85294) authorized an aggregate increase in Edison's base rates amounting to approximately $122 million in annual revenue effect. In rendering Decision No. 86794, the Commission approved rates predicated upon Commission adopted estimates of sales and revenues, expenses and rate base together with a rate of return determined by the Commission to be the minimum required, under the standards it stated were defined by this Court in the *Hope* and *Bluefield* cases, for the test year 1976, *i.e.*, to enable the Appellant to attract capital at a reasonable cost and not to impair its credit.

5. After Decision No. 86794 was issued, the Commission held further hearings to receive evidence among other things upon the issues relating to the investment tax credit ("ITC") and rate of return which the Commission had reopened the proceedings to hear pursuant to Section 1708 of the Public Utilities Code of the State of California.

6. After six days of additional hearings on those issues, and filing of briefs, the Commission issued, on September 7, 1977, its Decision No. 87828 which,

[4]Based on book life of plant which generated the credit (Section 46(f)(6), I.R.C.).

after clarifying what actions it had taken in Decision No. 86794 with regard to the derivation of the rate of return authorized by said decision (varying interpretations had been given by parties to the proceeding to those portions of Decision No. 86794), affirmed the said Decision No. 86794. (Dec. No. 87828; Appendix p. 135.)

7. Following the decisions of the Commission in said rate Application No. 54946, timely petitions for rehearing were made to the Commission (Appendix pp. 149 and 180) and were denied. (Appendix pp. 178-180.) Thereafter, petitions for writ of review were timely made to the California Supreme Court (Appendix pp. 182 and 204) and were denied by that Court on June 22, 1978 (Appendix pp. 278-279). Petitions for rehearing by the California Supreme Court were timely filed on July 7, 1978 (Appendix p. 250), and were subsequently denied by the Court on July 19, 1978 (Appendix pp. 280-281).

B. Undisputed Facts.

In the case at bar involving the aforesaid dockets, the following facts are indisputable from the record:

1. The Commission in setting the rate of return allowed to Edison in the case at bar relied upon its conception of the standard set by this Court in two cases; the Commission stated:

> "The United States Supreme Court has broadly defined the revenue requirements of utility companies as being the minimum amount which will enable the Company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (*Federal Power Commission, et al. v. The Hope Natural Gas Company* (1944) 320 US 591, 605; 88 L. ed 333, 346) and will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties (*Bluefield Waterworks and Improvement Company v West Virginia Public Service Commission* (1923) 262 U.S. 679, 692, 693; 67 L. ed at 1176)." (Dec. No. 86794 at p. 7; Appendix p. 5.)

2. Whether because of a misconception of such decisions of this Court[5] or otherwise, the Commission stated in its decision that the rate of return which it was authorizing was one which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" (Dec. No. 86794, p. 23; Appendix p. 21). *Cf. Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 605 (1944); and *Bluefield Waterworks & Improvement Company of West Virginia v. West Virginia Public Service Commission*, 262 U.S. 679, 692-93 (1923).

3. In adopting such minimum revenue requirement basis for fixing Edison's rates, it is indisputable that the Commission assumed in its decision that the increase in Investment Tax Credit ("ITC") provided by the Tax Reduction Act of 1975 would be available to Appellant as a credit and such credit was taken into account in determining its revenue requirements and

[5]See Reply Brief of Petitioner to Answer of Respondent, Docket Nos. S. F. 23605 and 23723, p. 2, *et seq.* (Appendix p. 230).

as a source of capital. (Dec. No. 86794, pp. 64-68; Appendix pp. 61-67; Dec. No. 87828, Findings 1 and 2, p. 18, and Conclusion 1, p. 19; Appendix pp. 133-135.)

4. If, contrary to the Commission's assumption, such ITC credits are not to be available to Appellant, it necessarily follows that the authorized rates and rate of return (which were designed upon the assumption of the continued availability of such credits) would not be designed to produce even the minimum revenue which the Commission determined to be required by law and would, at least to that extent, be confiscatory and thus unlawful.

5. As fully disclosed in Appellant's petitions below (Appendix pp. 225-226), after the clarifying decision by the Commission (Dec. No. 87828), Appellant sought a revenue ruling from the Internal Revenue Service (IRS), concerning its eligibility for the additional ITC (by letter dated September 22, 1977, which was in a form that the California Commission had had an opportunity to review before it was filed). As of the date of the preparation of our jurisdictional statement, the IRS has not ruled upon the question,[6] and, while Appellant hopes to obtain a favorable ruling, in light of the clarifications by the Commission in Decision No. 87828, and the differences believed to exist between the factual situations in this case and in those cases involving other California utilities where unfavorable IRS rulings were issued,[7] Appellant would suffer irrep-

[6]Appellant intends to promptly advise the Court of the receipt of any such ruling and submit a copy thereof.

[7]*E.g.*, Ex. 125 Southern California Gas Company Ruling (T:C:E:A:3; Appendix p. 282). *Cf.* IRS information letters (Appendix pp. 296 and 301).

arable damage should a similarly negative IRS ruling be issued with respect to its request. In all cases to date, of which we are aware, in which the IRS has issued rulings concerning rate actions taken by the Commission involving other California utilities, the IRS has concluded that the ITC eligibility would be lost because of rate treatment applied to such federal income tax benefits by the Commission.[8]

The amounts involved are substantial, running into many millions of dollars,[9] and the loss of such additional ITC benefits could adversely impact not only Appellant's ratepayers and customers but its employees as well because of the TRASOP aspects of the matter.[10]

6. The Commission itself has recognized that continued eligibility for investment tax credit is in the public interest. For example, it stated in its Decision No. 87838 (on pp. 19-20) involving Pacific Telephone and Telegraph Company that:

> "Eligibility is the first issue to be determined. To render a decision which attempts to resolve

[8]We are advised that four more such rulings have been issued by the IRS subsequent to the close of the record in this case involving California telephone utilities and indicating loss of eligibility for tax benefits and that they have been included in Docket Nos. 78-606 and 78-607, App. D, pp. 95A and 116A, and App. E, p. 133A filed with the Court.

[9]The evidence in Appl. No. 54946 indicates that for Appellant loss of eligibility would result in a lost tax credit for the years 1975 and 1976 involving approximately $16 million and an estimated loss through 1980 in excess of an additional $138 million (exclusive of the loss of Tax Reduction Act Stock Ownership Plan (TRASOP) benefits, which result from the additional 1% tax credit under the Tax Reduction Act of 1975). Reenders, Ex. 130, p. 5; Ex. 131, Table 1; Appendix p. 226.

[10]Loss of eligibility would also involve possibility of loss of benefits to employees under TRASOP. Appendix p. 226.

these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision. In the final analysis a loss of eligibility to the utilities would not only create service problems (though certainly not of the scope described by the Pacific's [sic]) but would create staggering financial problems to be ultimately borne by the ratepayers whose interest we are attempting to redress. We believe that eligibility for these tax benefits should be retained and proceed on that basis."

7. In fixing a rate of return which the Commission determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison", it made no adjustment to allow for the fact that the new rates being authorized by its decision would not be effective until *after* the end of the test year 1976 and excluded from rate base, to which such rate of return was applied, investment in certain plant items which were in service by the end of the test year.

8. The rates fixed by the Commission for Appellant have not been designed to enable it to sell new issues of its common stock except at prices significantly *below* book value with the resultant dilution of the equity interest of its existing common stockholders. To illustrate at page 20 of Decision No. 86794 (Appendix p. 19) the Commission recognized that the record indicated that a return on common equity of at least 13.28% would be required to raise market price to book value yet it allowed only 12.63%; the Appellant

issued 5,000,000 shares of common stock in 1976 which was marketed at $21.455 per share when the book value was $32.85.

The Rates Fixed by the Commission for Appellant Improperly Apply the Tests for an Adequate Rate Prescribed by the United States Supreme Court and Deny It the Opportunity to Earn an Adequate Rate of Return in Violation of Its Constitutional Rights.

A. The Commission Incorrectly Applied the Standards for Utility Ratemaking Established by the United States Supreme Court in a Number of Respects.

1. The Commission's Decision No. 86794 indicated that the Commission, while citing the decisions of this Court in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 615 (1944), and *Bluefield Waterworks & Improvement Co. v. West Virginia Public Service Commission*, 262 U.S. 679, 692-93 (1923), was operating under the misconception, in fixing Appellant's rates, that such decisions *precluded* the Commission, in the exercise of its jurisdiction, from authorizing rates which would be higher than the minimum amount required to enable Appellant to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (see Dec. No. 86794, *mimeo* p. 7; Appendix p. 5).[11] This is a demonstrably erroneous regulatory standard or limitation upon a regulatory commission's authority that is not required by the decisions of this Court relied upon by the Commission or by any other decisions of this Court.

a. While such decisions establish, as a *constitutional* matter, that rates which do not meet such minimum

[11]See quotation on pp. 8-9, *supra*.

standards are unlawful, there is nothing in said decisions to suggest that a regulatory commission, in carrying out its responsibilities to fix just and reasonable rates, cannot lawfully set rates at a higher level than such constitutional minimum where it is persuaded that the conditions justify it. To the contrary, this Court stated, in *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. 283, 317, ". . . we have emphasized that the courts are without authority to set aside any rate adopted by the commission which is within a 'zone of reasonableness.' . . ." (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968)). There are numerous cases, including earlier decisions of the California Commission, where the setting of rates higher than the minimum, within such zone of reasonableness, has been deemed appropriate and lawful (*e.g.*, *Banton v. Belt Line Railway Corp.*, 268 U.S. 413, 422-24 (1925); *Pacific Telephone and Telegraph Co. v. Public Utilities Commission*, 34 Cal. 2d 822, 829, 215 P.2d 441, 445 (1950); *Southern California Edison Co.*, 72 CPUC 282, 289 (1971)). It is a matter of economic fact that, in periods of continuing inflation, unless general rate applications are to be filed by the utility and processed by the regulating commission on an annual basis, rates must necessarily be fixed on the basis of revenue requirements above the minimum required based on test year cost of service or the utility will be effectively denied the opportunity to earn (in the period subsequent to the test year) the minimum earnings determined by the Commission to be required.[12]

[12]*Cf. New England Telephone & Telegraph Co. v. Massachusetts Dept. of Public Utilities*, 354 N.E.2d 860, 864-68, 16 PUR 4th 346, at 349-50.

b. Inasmuch as the Commission's Legal Staff, in an answer subsequently filed on behalf of the Commission with the California Supreme Court, stated it "admits, as it must, that neither *Hope* nor *Bluefield* require that the 'minimum' rate of return found to be reasonable must be the one adopted," it must be pointed out that this issue was raised in Edison's petition for rehearing dated January 7, 1977,[13] and that the Commission, as distinguished from its Legal Staff, neither granted rehearing on that issue nor clarified, nor corrected, nor denied that it had felt itself legally required, in issuing its Decision No. 86794, to fix utility rates at such minimum, nor denied that it had applied such an improper standard.[14]

c. The rate of return to be allowed by a regulatory commission in any particular rate proceeding normally falls within a range of reasonableness, and that rate of return which is the minimum necessary to avoid unconstitutional confiscation would obviously not exceed the bottom of that range (*cf. New England Telephone & Telegraph Co. v. Department of Public Utilities*, 354 N.E.2d 860, 868 (Mass. 1976)).

2. In addition, in fixing Appellant's rates in these proceedings, the Commission also failed in other respects properly to apply the tests for an adequate rate of return laid down in the *Hope* and *Bluefield* cases.

a. It is respectfully submitted that when a utility is denied the opportunity, as in this case, to earn

[13]See "Petition of Southern California Edison Company for Rehearing of Decision No. 86794 or for Reconsideration and Modification Thereof" dated January 7, 1977, pp. 1-3; Appendix p. 149.

[14]Dec. No. 86986, dated February 15, 1977, denying rehearing as to this issue. Appendix p. 175.

a return which would avoid continued dilution of existing shareholders' interests, by precluding the necessity of issuing additional common stock below book value, the tests of the aforesaid cases as to the adequacy of the return allowance have not been met. To state the matter in another way, a rate which assures continued dilution of existing shareholders' interests does not enable the utility to attract capital on reasonable terms and does not avoid impairment of the utility's credit. Thus it cannot be considered adequate under *Hope* and *Bluefield.*

b. The *Hope* and *Bluefield* decisions of this Court have laid down the tests of the adequacy of the rates authorized in the following terms: the rates must afford the utility a reasonable opportunity to realize earnings which (1) must be comparable to earnings on investments of similar risk, (2) must be such as not to impair the credit of the utility, and (3) must enable the utility to attract new capital. (See: 262 U.S. 679, 693; 320 U.S. 591, 603.)

c. It is demonstrable that the Commission's decisions in these proceedings fail to meet these tests.

(1) The Commission's adoption of a 12.63 percent return on common equity, for the purpose of determining the minimum required rate of return which it used in fixing rates, is grossly inadequate to permit Appellant's common stock to be issued to yield net proceeds approximating book value. This is clearly indicated not only by the recognized record showing that a return on common equity of at least 13.28% would be required to raise market price to book value (Decision No. 86794, p. 20; Appendix p. 19) but also by Appellant's experience after the partial general increase authorized by Decision No. 85294 on December

30, 1975 (after which Appellant's common stock throughout 1976 continued well below book value, never reaching as high as $24.00 per share although the book value as far back as December 31, 1973, was over $28.00).[15] Since the issuance of its Decision No. 86794 Appellant's common stock has continued to sell well below book. It is, of course, fundamental that if new stock yields net proceeds less than book value, the equity of existing shareholders is subjected to forced dilution (*cf. New England Telephone & Telegraph Co. v. Department of Public Utilities,* 354 N.E.2d 860, 865-67 (Mass. 1976)).

(2) That Appellant has been denied the opportunity to realize earnings comparable to those on investments involving similar risks, is indicated by the fact that the stock of Appellant has continued to sell substantially below book (more than 20 percent below book value), while those of most other similar electric utilities in the country have been selling at prices which approach or exceed book value.

B. Having Set the Authorized Rate of Return at the Minimum Found by the Commission to Be Necessary, the Commission Then, by Its Decisions, Arbitrarily and Unlawfully Produced Results Which Precluded Appellant From Any Opportunity to Earn Even Such Minimum for the Test Year.

1. It is respectfully submitted that it cannot be reasonably concluded that there has not been an unlawful confiscation where a state regulatory commission

[15]Even such increase to book value would be insufficient to enable new stock to be issued without forced dilution since selling costs and market pressure resulting from a new issue would result in net proceeds per share being below book value. Edison issued 500,000 shares of additional common stock in 1976 at a net proceeds of $21.455 per share when the book value per share was about $32.85 resulting in a dilution of existing shareholders interest amounting to about 3.3%.

had ordered utility rates designed to produce only the *minimum* return required by law and in so doing had erroneously assumed the existence of a tax credit to operating expenses without which the rates so fixed would produce less than the minimum return required by law. The logic supportive of such belief may be set forth in syllogistic form as follows:

Major Premise: Anything below the minimum required by law is confiscatory.

Minor Premise: Rates here were designed to produce, *with* the assumed availability to Appellant of the increase in the Investment Tax Credit under the Tax Reduction Act of 1975, the minimum required by law.

Conclusion: *Without* the assumed benefit of the increase in the Investment Tax Credit, the rates designed here would be below such minimum and would thus be confiscatory.

2. That the Commission, in its determination of Appellant's minimum revenue requirements for test year 1976 in the case at bar, assumed that Appellant would be eligible for the additional Investment Tax Credit benefits provided by the Tax Reduction Act of 1975, as extended by the Tax Reform Act of 1976, is manifestly clear from the following portions of the Decisions appealed from:

(a) "Another factor for consideration in arriving at the proper rate of return level is the additional investment tax credit benefits accruing to Edison as a result of the Tax Reduction Act of 1975 (TRA). The record shows that Edison elected Option 2, ratable flow-through, for the additional 6 percent investment tax credit

provided for by TRA." (Dec. No. 86794, p. 22; Appendix p. 20.)

(b) "After careful consideration of all the previously discussed relevant factors in the development of a reasonable return on common equity we adopt as reasonable a return on equity of 12.63 percent which, applied to our adopted capital structure and costs, translates to a rate of return of 8.8 percent developed as follows:

	Capital Ratio	*Cost Factor*	*Weighted Cost*
Long Term Debt	49.95	6.51	3.25
Preferred & Preference Stock	13.63	6.94	.95
Common Equity	36.42	12.63	4.60
Total	100.00	—	8.80

"This return on capital is the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. This rate of return will provide an approximate times interest coverage after income taxes of 2.71 times and an interest plus preferred dividend coverage of 2.09 times. Relating this 8.8 percent rate of return to our subsequently discussed adopted summary of earnings for Edison's California jurisdictional operations results in a gross revenue increase of approximately $122.5 million over the rates authorized by Decision No. 81919,[16] or $44.5 million over the rates authorized by Decision No. 85294.[17]" (Dec. No. 86794, p. 23; Appendix pp. 20-21.) (Footnotes added.)

[16]The final decision in Appellant's most recent prior general rate case.

[17]The decision granting a partial increase in Appl. No. 54946.

(c) "TRA, signed into law by the President on March 29, 1975, provides, among other things, for an increase in the investment tax credit rate from four percent to 10 percent (seven percent for certain transmission lines for new qualified plant expenditures made subsequent to January 21, 1975 and before January 1, 1977, when the investment tax credit reverts back to the previous rate.

"TRA further provides that those utilities, such as Edison, that use flow-through accounting for tax depreciation may elect, by June 26, 1975, one of the following three options . . . Option 2-credit income with the amortization of investment credit over the life of the property (ratable flow-through) . . . On June 25, 1975 Edison elected Option 2-ratable flow-through.

"TRA also provides that the additional ITC benefits shall not apply if the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of the allowable credit or if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the allowable credit." (Dec. No. 86794, pp. 63-65; Appendix pp. 62-63.)

(d) "The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975." (Dec. No. 87828, p. 19; Appendix p. 134.)

3. The general approach employed by the Commission for determining what constitutes permissible rates is to determine with respect to a "test period" (1) the rate base (investment) of the utility, (2) gross operating revenues under existing rates, (3) operating costs and expenses allowed for ratemaking purposes, and (4) the net revenues or return on investment produced thereby. Then by determining the rate of return to be fixed or allowed upon its rate base measured by the utility's cost of capital and comparing the net revenue (return on rate base) which would be earned under existing rates with the net revenue (return) required for the test period based on the cost of capital, the Commission determines how much the utility's rates and charges should be raised or lowered (*cf. Pacific Telephone & Telegraph v. Public Utilities Commission*, 62 Cal. 2d 634, 644-45, 401 P.2d 353, 359, 44 Cal. Rptr. 1, 7 (1965)). Under such a procedure, an increase in a cost or operating expense item will result in an increase in the revenue requirement needed to be covered by rates and similarly the loss of or a decrease in a credit to an operating expense or cost item also results in an increase in the revenue requirement (*cf. City and County of San Francisco v. Public Utilities Commission*, 6 Cal. 3d 119, 122-23, 490 P.2d 798, 799, 98 Cal. Rptr. 286, 287 (1971)).

Thus, when rates are fixed under an erroneous assumption as to the availability of revenue at existing rates or credit to an operating expense item, they produce less net revenues (return) than they were designed to produce. It follows that, if rates are fixed at the *minimum* level required by law to meet the

constitutional earnings tests of *Bluefield* and *Hope,* and if such rates are based upon an erroneous assumption as to the availability of an income tax credit item, then the rates so authorized will not produce the minimum revenue requirement and they are confiscatory. (See *Board of Public Utility Commission v. New York Telephone Co.,* 271 U.S. 23, 31 (1926).

In the case at bar, if the experience of Appellant proves to be similar to the experience of Southern California Gas Company, Pacific Telephone & Telegraph Company and General Telephone Company (that the actions taken by the Commission in the rate Decisions appealed from are ruled by the IRS to render it ineligible for the income tax benefits), such tax benefits being assumed by the Commission to be available to Appellant in fixing its rates at the minimum level required by law, Appellant would incur irreparable damage. This follows because under the proscriptions against retroactive ratemaking and under the historically established principles of constitutional law, the Commission could not in the future properly make Appellant whole by increasing future rates higher than they should otherwise be, because of such past losses. Past losses cannot be used to enhance the value of the property or support a claim that rates for the future are confiscatory (*see, Board of Public Utility Commission v. New York Telephone Co.,* 271 U.S. 23 (1926); *Georgia Railway & Power Company v. Railroad Commission,* 262 U.S. 625 (1923); *Galveston Electric Co. v. Galveston,* 258 U.S. 388, 395 (1922); *Pacific Telephone & Telegraph v. Public Utilities Commission,* 62 Cal. 2d 634, 401 P.2d 353, 359, 44 Cal. Rptr. 1, 7 (1965)).

It has been judicially recognized that a commission's placing of a utility in such jeopardy with regards to

eligibility for tax credits is an unreasonable exercise of power and abuse of discretion. See: *New England Telephone & Telegraph Co. v. Public Utilities Commission,* Slip Op., pp. 12-36 (Maine S. Ct., June 28, 1978) Division No. 752, CCH Utilities Law Reports—State, 7-31-78 Par. 22596.03 where the court, in reversing and remanding a Maine Commission decision concerning, among other things, the Commission fixing of rates in an manner jeopardizing the eligibility of a telephone utility for accelerated depreciation for tax purposes, stated (at pp. 35-36):

> "We find there is reasonable likelihood that New England would lose its ability to take accelerated depreciation or, at least, be subject to federal action with respect thereto. The effect of the Commission decree, if sustained by the Court, would be, at least, to place New England in jeopardy of losing its ability to take accelerated depreciation for federal income tax purposes.
>
> "The Commission treatment of accelerated depreciation in this case was to act directly contrary to the national economic policy set by the Congress of the United States. No reasonable justification for the action taken can be found in the record.
>
> "In conclusion, we find that the Commission's action with respect to the accelerated depreciation issue constitutes an unreasonable exercise of power and abuse of discretion for two reasons. First, it *arbitrarily* disregarded the normalization method of accounting, which it had ordered New England to follow. Second, it arbitrarily placed New England in jeopardy of losing its ability to take accelerated depreciation."

4. In addition, since the new rates here involved did not become effective until after the 1976 test year, Appellant could not possibly earn the authorized minimum rate of return. In establishing a rate of return which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison," the Commission made no adjustment therein to allow for the fact that the new rates here involved would not be effective until *after* the end of the test year (Appendix p. 150); the result is an obvious inability, under such circumstances, due to earnings attrition as a result of continuing inflation, of Appellant to earn the rate of return the Commission deemed to be the minimum required. It is manifestly clear that the return which the Commission finds to be the "minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" cannot be earned utilizing rates, based upon such rate of return, which will not be effective until some time after the end of the test period 1976.

5. Furthermore, the Commission arbitrarily refused to include in rate base plant items which the uncontroverted record showed did not contribute to increased capacity of the system, and therefore are not, when operational, associated with increased load or sales. Because such plant became operational before the rate increases authorized by the Decision were to be effective and the allowance for funds on such investment (ADC) terminated prior to such rate increases becoming effective, the Commission's action unreasonably and erroneously denied the utility an opportunity to earn upon such plant devoted to a public use. The exclusion of such items from rate base and the resulting prevention of any opportunity to earn upon such plant

devoted to a public use violates Appellant's constitutional rights and is a denial of due process of law (Appendix p. 151, *et seq.*).

6. Nor can the Commission under the constitutional standards prescribed by this Court in the *Hope* and *Bluefield* cases properly fix rates which are not reasonably designed to provide the utility with an opportunity to earn a return that will avoid continuing dilution of the interests of the common stockholder because the earnings realistically contemplated are insufficient to support the sale of new common stock at prices at least approximating book value. In a case involving a situation which, in this respect, is substantially on all fours with the case at bar, the Supreme Judicial Court of Massachusetts recognized the constitutional inhibitions upon such action in *New England Telephone & Telegraph Co. v. Department of Public Utilities,* 354 N.E.2d 860, 868 (Mass. 1976).

The Questions Involved Are Substantial and Have Far Reaching Effects.

A. Any application by the California Commission of the misconception that the decisions of this Court require that utility rates be fixed by a state regulatory commission at no more than the minimum level required to avoid confiscation, and that such state regulatory bodies are precluded from allowing higher rates within a zone of reasonableness, would obviously adversely affect investor attitude with respect to investing in such utilities and thus would have far reaching and disastrous effects upon the ability of the utility industry to raise the enormous amounts of additional capital required to build the facilities needed to provide adequate public utility service in the future.

B. Loss to Appellant of eligibility for investment tax credit benefits because of regulatory action, or for any reason, would result in substantial irreparable harm. The loss of such investment tax credit benefits alone would result in approximately $150 million of tax increase to Appellant for the period 1975 through 1980 and result in the confiscation of property of Appellant and its shareholders of over $3 million during the period, aside from the dilutive effect on existing shareholder interests of issuing new common stock at prices below book value, and would preclude tax benefits amounting to more than $300 million being ratably flowed through to Appellant's ratepayers over the life of the property giving rise to such tax benefits.

In addition, such disallowance could also result in the loss to the approximately 13,000 Edison employees of some $26 million in Edison stock because of the possibility of loss of eligibility for the additional investment tax credit provided by the federal government under the employee stock ownership plan (known as TRASOP or ESOP) (I.R.C. §46(a)(2)(b)).

Under the provisions of the Internal Revenue Code involved here, Congress has, in effect, granted benefits to be shared by the ratepayers, the shareholders, and utility employees. Such benefits are designed to help finance the construction needs of the utility industry, while at the same time provide the rate relief to ratepayers, and benefits to utility employees. The public interest aspects involved in carrying out the will of the Congress in enacting such federal tax laws and in maintaining eligibility thereunder is manifestly clear. The overriding importance of this matter has not been challenged. The Commission itself has recognized that

the public interest is so served and indicated in the final analysis a loss of eligibity to the utilities would not only create service problems, but would create staggering financial problems to be ultimately borne by the ratepayers.

The tax policies established by the Congress in providing such substantial investment tax credits and benefits in the federal tax laws should, we respectfully submit, not be permitted by this Honorable Court to be thwarted by a clash or controversy between the state regulatory commission and the Internal Revenue Service over the appropriate standards of eligibility under the federal tax laws.

Conclusion.

Based upon the foregoing, and the substantial federal questions raised therein, Appellant respectfully submits that this Court should assert jurisdiction in this case.

John R. Bury,
William E. Marx,
Rollin E. Woodbury,

Attorneys for Appellant Southern California Edison Company.

IN THE

Supreme Court of the United States

October Term, 1978

No. 78-616

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

APPENDICES TO JURISDICTIONAL STATEMENT

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INDEX TO APPENDICES

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APPENDICES TO JURISDICTIONAL STATEMENT

APPENDIX 1.

Decision No. 86794 (12/21/76).

Decision No. 86794

Before the Public Utilities Commission of the State of California.

In the matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

(Appearances listed in Appendix A)

OPINION

Southern California Edison Company (Edison) seeks authorization to increase its California jurisdictional electric rates approximately $339 million (21 percent) annually at the estimated 1976 level of sales. Edison originally estimated that the proposed rates, if effective for the full-year 1976, would produce a rate of return of about 9.6 percent on California jurisdictional operations. Its updated estimates, however, indicate that the proposed rates would yield a full-year 1976 rate of return of 9.4 percent.

After notice, 102 days of hearing were held before Commissioner V. L. Sturgeon and/or Examiner N. R. Johnson during the period November 6, 1974 through January 23, 1976, and the matter was submitted subject to receipt of concurrent opening briefs due on or before March 8, 1976 and concurrent closing briefs due on or before March 29, 1976.

In addition to Edison and the Commission staff, opening and/or reply briefs were received from the

California Department of Water Resources (DWR), California Manufacturers Association (CMA), Committee to Protect California Economy (Committee), Metropolitan Water District of Southern California (MWD), Secretary of Defense on behalf of the Consumer Interests of All Executive Agencies of the United States (Government), Toward Utility Rate Normalization (TURN), and Western Mobilehome Association (WMA).

I—EDISON'S PRESENT OPERATIONS

Edison furnishes electric service to over 315 unincorporated communities and 145 incorporated cities, or portions thereof, and outlying rural areas in 15 counties in central and southern California. The population of the area served was estimated to be 7,508,000 as of December 1973.

Edison also sells electric power for resale to the cities of Anaheim, Azusa, Banning, Colton, Riverside, and Vernon, and to Sierra Pacific Power Company, Southern California Water Company, Anza Electric Cooperative, Valley Electric Association, and the United States Naval Ammunition Depot at Hawthorne, Nevada. Electric power is also sold to, purchased from, or interchanged with Arizona Public Service Company, Bonneville Power Administration, Department of Water and Power of the city of Los Angeles, El Paso Electric Company, Imperial Irrigation Company, Portland General Electric Company, Public Service Company of New Mexico, Sacramento Municipal Utility District, Salt River Project, San Diego Gas & Electric Company, Sierra Pacific Power Company, State of California, and the United States Bureau of Reclamation.

Edison owns and operates 36 hydroelectric plants, 14 thermal electric generating plants, one diesel electric plant; it operates one jointly owned, coal-fueled thermal electric plant, one jointly owned thermal electric nuclear plant, and an electrical system owned by the city of Vernon; in addition, others operate for Edison and other agencies one jointly owned, coal-fueled thermal electric plant and one gas and oil-fueled generating plant. The total effective operating capacity of these facilities available to Edison under optimum conditions, as of year-end 1973, was 12,265,695 kilowatts. As of the year-end 1973, Edison had available to it an additional 887,600 kilowatts of firm capacity under terms of power purchase agreements, 277,000 kilowatts of effective operating capacity at the Hoover Dam Power Plant, and 17,060 kilowatts via the United States Bureau of Reclamation at the Parker Dam sites.

As of December 31, 1973 Edison had approximately 11,188.2 miles of transmission lines, approximately 40,742 miles of overhead distribution lines, and approximately 18,473 miles of underground distribution cable of 16 kv or less.

At year-end 1974, Edison had a total of 2,691,691 California jurisdictional customers of which 2,385,705 were classified as residential customers.

II—PARTIAL GENERAL RATE INCREASE

On November 4, 1975, after 85 days of hearing and a record which included 97 exhibits and more than 7,000 pages of transcript, Edison moved that this Commission grant, as an initial phase of this proceeding, a partial general increase in the amount shown by the record to be justified based on the

Commission staff's estimates of revenues, expenses, and rate base as related to its recommended rate of return.

In Decision No. 85294 dated December 30, 1975 we found that because of the probability that a decision in this matter would not be issued in time to provide the test year 1976 revenues found necessary for jurisdictional operations, a partial general increase in rates to be construed as an initial phase in this proceeding was justified to arrest Edison's continuing erosion of earnings, to materially improve its financial performance, to enhance its ability to raise the additional capital required for financing its continuing construction programs, to provide better investor acceptance of its securities, and to reduce the risk of having these securities derated.

The amount of the partial general rate increase authorized was based on the staff's showing that $80 million of additional revenues was required to provide the 12.25 percent return on equity adopted as reasonable in Decision No. 81919 dated September 25, 1973 on Edison's Application No. 53488 for a general rate increase.

This $80 million partial increase, with one exception, was apportioned to the various customer groups on a uniform cents per kilowatt-hour basis because at that time ". . . the record is not yet completed or fully argued on the appropriate rate design for the apportionment of the authorized partial general increase, we are not in a position to logically apportion this increase to the various customer groups in accordance with one rate spread recommendation in preference to another." (Decision No. 85294, mimeo page 12.)

The above noted exception was that portion of the domestic rate within the 0 to 300 kilowatt-hour a month consumption block which had substantially no increase and was considered as the first step in the establishment of lifeline rates for Edison as required by AB167. These rates, further discussed in Section VI of this decision, reflect a simplified rate structure consisting of a customer charge and two energy blocks (0-300 kilowatt-hours per month and over 300 kilowatt-hours per month).

III—RATE OF RETURN

General

The United States Supreme Court has broadly defined the revenue requirement of utility companies as being the minimum amount which will enable the company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (*Federal Power Commission et al. v. The Hope Natural Gas Company* (1944) 320 US 591, 605; 88 L. ed 333, 346) and will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties (*Bluefield Waterworks and Improvement Company v West Virginia Public Service Commission* (1923) 262 US 679, 692, 693; 67 L. ed at 1176). The determination of the sum specific to satisfy those requirements dervies from the application of logic and informed judgment to numerous complex and interrelated factors such as the cost of money, capital structure of the utility in question as compared

with other similar utilities, interest coverage ratios, return on common equity, price/earnings ratios, and price/book ratios. In California this net revenue requirement is expressed as a percentage return on weighted average depreciated rate base for California jurisdictional operations and is intended to provide sufficient funds to pay interest on the utilities' long-term debt, dividends on its preferred and preference stock, and a predetermined reasonable return on common equity. Complete showings on the revenue requirement of Edison in this matter were presented by Edison and the Commission staff. In addition, in its briefs Government and TURN argued that the return on equity of 12.25 percent found reasonable in Decisions Nos. 81919 and 85294 is adequate and need not be increased.

Position of Edison

An overview of Edison's position relative to the amount of a revenue increase needed was presented by its chairman of the board of directors and chief executive officer, Mr. J. K. Horton. He testified that it was necessary to file this, the fourth general rate increase application in a six-year period, because of the continued worsening of the economic climate in which Edison must operate. According to his testimony, the problem of general inflation has been aggravated by the current energy source shortage and its effect on fossil fuel prices and by environmental control measures that not only result in substantially higher operating costs but frequently involve significant investment in production equipment, which is not only expensive and nonrevenue producing, but also sometimes tends to reduce the operating efficiency of the utilities' facilities. To combat experienced attrition he recommended the adoption by this Commission of a range of reasonableness of plus or minus 0.75 percent for rate of return and plus or minus two percent for return on equity, with the initial rates designed to produce earnings at the upper end of the range. Such action would, in his opinion, insure Edison's earning the full authorized rate of return for the test year in question. In addition, he proposed adjustment clauses, similar to existing fuel cost adjustment clauses, which would permit expeditious rate adjustment procedures to track changes in such basic items as property taxes, labor rates, and bond interest.

Edison's basic presentation on its required revenue increase, expressed as a requested rate of return of 9.6 percent on depreciated rate base, was made by its then financial vice president, the late Mr. Smith B. Davis. He assumed a capital structure consisting of 50 percent debt with an embedded cost of 6.31 percent, 13 percent preferred and preference stock at a cost of 6.91 percent, and 37 percent common equity with a return on equity of 15 percent. Inasmuch as most of the cost of bonds and preferred stock, fixed by the terms of the offering, are already a matter of record, controversy on an appropriate allowable rate of return centers about the appropriate return on common equity that should be permitted. This return on common equity allowance is necessarily a judgment figure based on many factors such as trends in interest rates and coverages for senior securities, earnings comparisons, capital structures, and the financial health of the involved utility.

Mr. Davis' testimony was included in Exhibits 4 and 40. In addition, he presented statistical comparisons and other financial data in Exhibits 1, 1A, 8, 8A,

38, and 39. The salient points emphasized in his presentation are as follows:

1. Edison estimates that for the period 1974-1978 it will have to rely on external financing for about $471,000,000 a year (approximately 71 percent of its requirements) as contrasted to approximately $166,000,000 (approximately 55 percent of its requirements) a year for the period 1963-1973.
2. During the most recent two years new Aa public utility bonds and public utility preferred stock have been issued at a cost ranging from 7.0 to 8.5 percent with the most recent issue of bonds going for 8.05 percent and the most recent issue of preferred stock costing 8.60 percent. (In its reply brief, Edison notes that its $150 million Series FF bonds were issued on March 6, 1975 at a cost of 9.03 percent, its $125 million Series GG bonds were issued on March 17, 1976 at a cost of 9.04 percent, and that $50 million preferred stock issued in June of 1975 sold that month at a cost of 9.47 percent.)
3. Edison's embedded cost of debt rose from 3.97 percent in 1963 to 5.56 percent in 1973 and is expected to increase to 6.31 percent in 1976.
4. Comparative statistics of operating and financial characteristics were developed for the 20 largest electric utilities, for Moody's 24 public utilities consisting of 14 electric utilities and 10 combination utilities, and for Moody's industrials consisting of a composite group of 125 unregulated companies representing almost all major stan-

dard industrial classification codes (SIC Codes). These comparative statistics generally indicate that most of the 20 largest utilities and Moody's 24 utility companies are similar to Edison with respect to bond rating, times interest coverage ratios before and after taxes, and capital structure and that Edison's earnings per year growth has averaged about the same or somewhat less than those of these other comparison companies.
5. Utilities having Aa rated bonds should aspire to the maintenance of interest coverage of about 4.0 times before taxes and about 3.0 times after taxes.
6. A loss in bond rating from Aa to A not only increases the cost of debt but tends to reduce available markets because of investment laws which restrict banks, insurance companies, and other institutions from purchasing bonds and preferred stock which do not meet specified minimum coverage requirements.
7. The derating of utility bonds from Aa to A is a real threat as evidenced by the number of electric utilities that have been derated during the 1968 to 1973 period.
8. Edison's experienced and trended return on common equity is well below the 20 largest utilities, Moody's 24 utilities, and Moody's industrials.
9. Edison's stock prices have declined more during the period from year-end 1968 to year-end 1973 than have the stock prices of the comparison companies.
10. The price/earnings ratio for Edison and the two utility groups averaged well below those

of Moody's industrials during the 1963-1973 period.

11. For the 20 largest utilities and Moody's 24 utilities to reach parity in price/book ratios with industrials, the return on common equity required would appear to average between 15 and 16 percent for the 1963-1973 period and between 17 and 18 percent for the 1968-1973 period.

12. The inclusion of $400 million nonoperative construction work in progress in rate base would help mitigate Edison's serious cash flow problem by increasing cash flow by $38.4 million for 1976, $40.3 million for 1977, and $42.3 million for 1978, a total of $121.1 million for these three years. Furthermore, according to Mr. Davis' testimony, this additional cash flow, coupled with the accompanying dividend savings realized as a result of selling fewer shares of common stock, would decrease Edison's external financing requirements by $138.5 million.

Mr. Davis further testified that because of the increase in cost of debt and preferred and preference stock since the application was filed, it would be necessary for Edison to earn a rate of return of 9.73 percent to provide the requested return on equity of 15 percent.

Position of Commission Staff

The staff position on the cost of capital and recommended rate of return was presented by Financial Examiner IV Russell J. Leonard. Mr. Leonard's prepared testimony discussed his accompanying exhibit containing 27 tables and 8 charts concerning interest rates, debt

costs, earnings, capital structure, financing and other data pertaining to growth in net plant investment, revenues, expenses, and customers. Trends and five-year averages are shown for the years 1967-1973 in many of the tables in a form which compares Edison's operating results with averages developed for 10 electric utilities, Pacific Gas and Electric Company (PG&E), and 10 combination gas and electric utilities.

Mr. Leonard assumed anticipated debt issues aggregating $160 million in 1975 and $303.5 million in 1976 to which he applied estimated interest rates of six percent for pollution control bonds, eight percent for mortgage bonds, and 6.64 percent for notes to yield an estimated embedded cost of debt as of December 31, 1976 of 6.35 percent. Under cross-examination he increased this to 6.45 percent to reflect the cost experienced with the latest offerings. In addition, Mr. Leonard included in his estimate a $75 million preferred stock issue with an estimated dividend rate of eight percent resulting in an overall preferred and preference rate of 6.87 percent. This figure was also revised upwards during cross-examination to 6.94 percent to reflect an actual issue of $50 million of preferred stock in June 1975 at a cost of 9.47 percent.

Mr. Leonard testified that a comparison of reported earnings and related data for the selected group of utilities was used as a guide in the development of a range of recommended rate of return. He noted, however, that the recorded comparison data does not reflect the consequences of adjustments which would be considered in the ratemaking process and that the experienced earnings may be above or below normal. In addition, differences in the operations of comparison companies, such as income derived from nonutility

operations, consumer mix, types of service provided, and the economic and regulatory environment of their respective service areas, necessitate consideration of factors other than historical earnings comparisons. Mr. Leonard did not include comparison data for industrial enterprises because the business and financial risks of such enterprises differ from those confronting public utilities because of the cyclical nature of the industrial's earnings, the effect of competitive influences, and the generally higher proportions of common equity in their capital structure.

Mr. Leonard recommended an earnings allowance for common equity ranging from 11.99 percent to 12.77 percent with an approximate coverage for interest on long-term debt of 2.81 to 2.91 times after income taxes and a coverage for debt interest and for dividends on preferred and preference stock of 2.17 to 2.25 times after income taxes. The application of the range of return on common equity of 11.99 to 12.77 percent to the staff's assumed capital structure and cost of debt and preferred stock results in the staff's recommended rate of return ranging from 8.60 to 8.90 percent applicable to the California jurisdictional rate base as determined in this proceeding. Mr. Leonard testified that in his opinion the earnings resulting from his recommended rate of return would result in fair rates for consumers and provide a reasonable return to investors in Edison's common stock.

Position of Government

In its brief on this matter, Government argues that the United States Supreme Court has indicated that a utility's rate of return should be sufficient to enable a company to attract new capital and maintain its

credit standing and financial integrity and to provide a return to the equity holder commensurate with returns being earned on investments in other enterprises having corresponding risks.

Government further argues that ratemaking philosophy has developed to restrict earnings at or near the minimum level that meets such criteria and that, since embedded cost of debt and preferred stock are established by the terms of the offerings, such return is governed by the cost of common equity which in turn is governed by corresponding risks. According to Government, Edison's exhibit entitled "Financial Characteristics, Cost of Money, and Required Return" does not satisfactorily address the subject of corresponding risk. This conclusion is based on a table-by-table analysis of the exhibit as follows:

1. Tables 1, 2, 3, 4, 5, 6, and 7, together with Charts 1, 2, 3, and 4 do not address the subject of comparable risks.
2. Table 8A and Chart 5 deal with the embedded cost of debt.
3. Tables 9, 10, and 11 present data for comparative companies and the results, according to Government, indicate that Edison is in better financial shape than the other comparative companies.
4. Table 13 compares the operating chracteristics of utilities and Moody's industrials and, according to Government, is meaningless.
5. Edison's debt ratio has gone down over the past ten years while that of comparison groups has increased.

6. Edison's equity ratio has declined roughly half as much as that of comparison companies.
7. A list of bond deratings is interesting information but provides no information regarding comparable risks.
8. Computations regarding Edison's bond indenture and preferred stock coverage do not relate to comparable risks.
9. Data on comparative earnings, the bargain price of stock, price/earning ratios, and price/book ratios are of no value in determining required earnings on equity.
10. Tables 24 and 25 contain mathematical calculations deriving the ratios of price/book ratios of Moody's industrials to the price/book ratios of comparison utility companies and derive a factor which represents the average premium of recorded earnings over Moody's Aa utility bond yield. According to Government, these mathematical calculations have no value in determining required earnings on equity.

Government's overall conclusions from the above-described review of Mr. Davis' tables and charts is that there is little in those materials that addresses the subject of relative risk or comparable earnings and what little relative material there is contained in the exhibit indicates that Edison is in as good as or better position than the other groups. Therefore, Government concludes, earnings on equity for Edison should be in the 12 to 12.5 percent range.

Government further argues that the staff presentation is much more accurate and meaningful than that of Edison's and that a similar table-by-table review of

the staff showing presents us with many more measures of comparable risks than does the company showing. Government notes that Edison is comparable to the comparison groups set forth in the staff exhibit except in the area of operating expenses. From this comparison Government concludes that the staff's exhibit supports a return on equity allowance in the range of 12 to 12.5 percent, the same as resulted from its analysis of Edison's showing. Government compares its recommended range of return on equity to Decision No. 84902 dated September 15, 1975 on PG&E's Applications Nos. 54279, 54280, and 54281 wherein this Commission found that the minimum reasonable return on equity was 12.0 percent (mimeo page 129) and concludes that the return on common equity to be allowed in this case should not exceed the 12.25 percent found reasonable in Decision No. 81919.

Position of TURN

In its brief TURN argues that Edison is requesting the highest utility equity rate in the nation to permit it to compete in the capital market, restore premiums of common over bond yields, and achieve what Edison believes is proper interest coverage. TURN notes that witness testimony by Edison indicated that returns on investment and equity were not exorbitant in the context of the then existing 10 percent prime rate and eight to nine percent bond rate. TURN notes that Decision No. 85294, effective December 30, 1975, granted an $80 million increase to provide a return on investment of 8.7 percent and return on equity of 12.25 percent. TURN notes that the authorized return on equity is above the minimum of the range recommended by the staff witness and argues that it is therefore fully

compensatory in view of the drop in prime rate from 10 percent effective in January 1975 to its present low level. TURN also assumes that the recent rise in stock prices will result in corresponding increases in the price of utility stocks. TURN further argues that this Commission must recognize Edison's relative financial good health and should, therefore, grant Edison no further increase.

Discussion

Edison's capital ratios at the end of the 1976 test year as estimated by Edison and the Commission staff are compared below together with the capital structure adopted in these proceedings:

Component	Applicant	Staff	Adopted
Long-Term Debt	50.00%	48.22%	49.95%
Preferred and Pref. Stock	13.00	13.11	13.63
Common Stock Equity	37.00	38.67	36.42
Total	100.00%	100.00%	100.00%

Both Edison and the staff provided for $290 million of external financing in 1975 based on estimated sales of securities consisting of long-term debt, $160 million; preferred stock, $50 million; and common stock, $80 million. The increase in retained earnings for 1975 was estimated as $64 million by Edison and $73 million by the staff.

A review of the Edison's 1975 annual report on file with the Commission discloses that (a) $161 million of long-term debt was issued at an approximate cost of 8.86 percent, including $150 million of Series FF bonds costing 9.03 percent; (b) $50 million of preferred stock was sold at a cost of 9.47 percent; (c) retained earnings increased by $65 million; and (d) additional common shares were not issued or sold during the year.

To satisfy expected construction outlays and bond refundings in 1976, Edison and the staff estimated that a portion of the needed funds would be obtained from issuance of long-term debt in the amount of $303.5 million and sale of $180 million of common stock. Edison estimated that the increment in retained earnings for the year would amount to $22 million as contrasted to the $108 million used by the staff which gave consideration to the impact of a general rate increase in 1976.

The Commission takes official notice of Decision No. 85491 dated February 20, 1976 under which authority Edison sold $125 million of its Series GG bonds in March at a cost of 9.00 percent. With respect to financing anticipated for the remainder of 1976, the company's 1975 annual report to stockholders states on page 12: "The timing and amount of additional external financing will depend largely on regulatory action relating to rates and market conditions but may amount to $150 million and include the issuance of common stock and other borrowings."

In light of these developments, it is evident that the estimates of both Edison and the staff are inapplicable in these proceedings. The capital structure urged by Edison does not represent an estimate of the actual position at the end of 1976 but rather an objective which it hopes to achieve; on the other hand, the staff's estimate does not reflect subsequent events.

The capital structure adopted herein as reasonable for the 1976 test year recognizes the financing which has actually been accomplished and simultaneously takes into account an increment of $55 million for retained earnings and the issuance of an additional

$150 million of securities segregated equally between debt bearing a 9.00 percent interest rate and common stock. As to the cost of senior securities, we will adopt as reasonable an embedded cost of 6.51 percent for debt and 6.94 percent for preferred and preference stock after considering the financing already completed in 1976 and to be undertaken for the remainder of the year.

One of the considerations in the determination of the amount of increase presently sought by Edison is the level of earnings necessary to restore the market price of its common stock to at least book value. According to the testimony of Edison's witness a return on equity of 15 percent will not automatically result in the restoration of the market price of Edison's common stock to book price but that absent such a return the achievement of this stated goal would be impossible.

In support of this position, Edison presented Table 24 of Exhibits 1 and 1A and Exhibits 10 and 10-A supplementing said Table 24. Table 24 was intended to establish a relationship between a change in return on common equity and a change in the price/book ratio by factoring the price/book ratios of Moody's industrials with price/book ratios of the 20 largest utilities and with Moody's public utilities. The relationship thus established indicated that the return on common equity necessary to raise the price/book ratio of utility stock up to that of Moody's industrials was 15.0 to 15.7 percent for the years 1963-1973 and from 17.3 to 18.1 percent for the years 1968-1973. Translating this data from the 20 largest electric utilities and Moody's public utilities to Edison's operations indicates that a return on common equity of 15 percent would raise Edison's price/book ratio to 1.2 times

the price/book ratio of Moody's industrials. In response to a question by the examiner, witness Davis admitted that according to the developed data a return on equity of 13.28 percent would raise Edison's price/book ratio from its existing level of 0.65 up to the desired 1.0.

Another factor utilized by Edison in support of its 15 percent return on common equity request is times interest coverage. Witness Davis testified that Edison required a 15 percent return on common equity to provide an interest coverage of about three times and that such a coverage is necessary for Edison to maintain its Aa bond rating. Mr. Davis further testified that although a 2.75 or 2.73 times interest coverage may have been satisfactory historically, he believes that because of Edison's large future construction requirements an increase to at least three times interest coverage will be required for Edison to maintain its present bond rating. In its brief, Edison argued that in Decision No. 81919 we found that an 8.2 percent rate of return resulting in 12.25 percent return on common equity and 2.91 times interest coverage after income taxes was the minimum rate of return which Edison needed to attract capital at reasonable cost and not impair its credit. Edison further argues that since the after tax interest coverage is a most important measure of the credit worthiness of a utility in the eyes of the investor, itis difficult to understand how a minimum coverage requirement of 2.9 times in 1973 can realistically become more than the maximum allowable coverage included in the staff's recommended range of rate of return after adjusting for the latest recorded embedded cost of debt and preferred stock dividend ratios. Staff witness Leonard testified under cross-examination that while times interest coverage was a factor con-

sidered in developing a recommended range in rate of return, it was a computed end result rather than a controlling factor in the determination of a recommended rate of return. In Decision No. 81919 we stated ". . . we find that 8.2 percent is a reasonable rate of return to be applied to the California jurisdictional rate base. This return is the minimum needed to attract capital at reasonable cost and not impair the credit of the utility. An 8.2 percent rate of return on that portion of capital ascribed to the California jurisdictional rate base would provide an approximate interest coverage, before taxes on income of 3.94 times, and 2.91 times after taxes." (Mimeo. page 70.) It is obvious that the minimum referred to was the rate of return and not the times interest coverage as Edison incorrectly alleges.

Another factor for consideration in arriving at the proper rate of return level is the additional investment tax credit benefits accruing to Edison as a result of the Tax Reduction Act of 1975 (TRA). The record shows that Edison elected Option 2, ratable flow-through, for the additional 6 percent investment tax credit provided for by TRA. In Decision No. 85627 dated March 30, 1976 on Southern California Gas Company's Applications Nos. 55676 and 55544 and San Diego Gas & Electric Company's Applications Nos. 55677 and 55543 in a similar situation, we found as follows: "5. A rate of return adjustment downward of 0.25 percent on an $824.5 million rate base will best recognize the reduction in risk claimed by SoCal in its choice of Option 2." Similarly in *Re SoCal Gas Co.*, Decision No. 86595 dated November 2, 1976 in Application No. 55345 at page 96, we recognized "that because of SoCal's election of Option II, cash flow would be maximized, interest coverage increased, and the

financial requirements in constructing facilities and acquiring gas supplies relieved". The corresponding reduction in risk redounding to Edison from its election of Option 2 was included in our considerations in arriving at our adopted rate of return.

After careful consideration of all the previously discussed relevant factors in the development of a reasonable return on common equity we adopt as reasonable a return on equity of 12.63 percent which, applied to our adopted capital structure and costs, translates to a rate of return of 8.8 percent developed as follows:

	Capital Ratio	Cost Factor	Weighted Cost
Long-term Debt	49.95	6.51	3.25
Preferred & Preference Stock	13.63	6.94	.95
Common Equity	36.42	12.63	4.60
Total	100.00	—	8.80

This return on capital is the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. This rate of return will provide an approximate times interest coverage after income taxes of 2.71 times and an interest plus preferred dividend coverage of 2.09 times. Relating this 8.8 percent rate of return to our subsequently discussed adopted summary of earnings for Edison's California jurisdictional operations results in a gross revenue increase of approximately $122.5 million over the rates authorized by Decision No. 81919, or $44.5 million over the rates authorized by Decision No. 85294.

IV—RESULTS OF OPERATION

General

Complete results of operation testimony and exhibits were presented by Edison and the Commission staff. In addition, Government's consulting engineer, Mr.

D. J. Reed, presented testimony and exhibits setting forth 1976 test year estimates of sales, revenues, and customer bills by rate schedules for domestic Schedules D-1 through D-6 and general service Schedules A-1 through A-8.

Edison's estimates reflect revenues and expenses including the effect of anticipated fuel cost adjustment billing factors (FCABF) whereas the staff's and Government's estimates reflect revenues and expenses at base costs authorized by Decision No. 81919. Government's estimates ae by rate schedule and are, therefore, not directly comparable to Edison's and the staff's estimates by revenue classifications. They do, however, encompass $27,805,000 of the total $28,384,000 differential between the staff's and Edison's estimates and were, therefore, valuable in making our determinations. With respect to the difference between revenue classification and rate schedule estimate presentations we stated in Decision No. 81919 as follows:

> "It should be noted that all of the customer groups as used by Edison and the staff are not strictly comparable to the classes of service under which Edison reports its revenues under the FPC's Uniform System of Accounts. The customer groups are directly related to the various rate schedules, whereas it is necessary to allocate revenues from some schedules in order to arrive at revenues for classes of service. Sales to public authorities are an example of this. In future rate cases it would be helpful if the presentations were consistent, and customer groups seem to us to be preferable for this purpose." (Mimeo page 73.)

The validity of this statement was emphasized by the inability to directly compare the estimates of record in this proceeding. Since estimates by rate schedules are utilized by Edison in the preparation of its revenue estimates, the omission of such data from the primary exhibits does not appear to be justified.

Before detailing the bases for adopting the individual revenue, expense, and rate base items, it is necessary to resolve the following three issues of general concern: (1) The proper level of fossil fuel costs to be used for the test year revenue and expense estimates; (2) the proper level of wage adjustment to be applied to the test year estimates; and (3) the effect of Edison's recent force reductions on test year operating costs.

The staff's estimates of operating revenues, presented by Associate Utilities Engineer V. G. Putnam, and fuel and purchased power expenses, presented by Associate Utilities Engineer H. J. Lindenmeyer, reflect base rates and unit fossil fuel costs established by Decision No. 81919 for a general rate increase on the basis that the fuel cost adjustment increments of revenues and expenses were properly includable in Case No. 9886, our investigation into electric utility fuel cost adjustment tariff provisions and procedures. Such a procedure was essentially adopted for a similar situation in Decision No. 84902 dated September 16, 1975 on Pacific Gas and Electric Company's (PG&E) Application No. 54279 for a general rate increase of its electric rates. Decision No. 85731 dated April 27, 1976 on Case No. 9886 established the parameters for the development of an Energy Cost Adjustment Clause (ECAC) to replace the existing Fuel Cost Adjustment Billing Factor (FCABF). The base rates incorporated into Edison's resulting ECAC are those

rates for electric service in effect on December 31, 1975 and consist of the rates established by Decision No. 81919 plus the fuel cost billing factor adjustment of 0.949 cents per kilowatt-hour authorized by Resolution No. E-1414 adopted November 13, 1974 and the partial general increase authorized by Decision No. 85294. Consistent with our action in Decision No. 84902 we will retain the individuality of these two separate matters by basing our adopted results of operations and revenue requirement computations on the base rates and unit fossil fuel cost established by Decision No. 81919.

Edison's presentation was premised on the assumption that a general wage increase of 7 percent would become effective January 1, 1976. For comparability the staff's estimate included such a wage adjustment which was then backed out as a lump sum adjustment on the basis that it had not been negotiated as of that time. Attached as Appendix B to Edison's reply brief was a copy of a letter to its supervisory personnel over the signature of Jack K. Horton, the chairman of the board, announcing the granting or offering of an 8.5 percent increase to employees. Under these circumstances a lump sum amount of $2,052,000 will be included in our adopted expenses to accommodate the difference between the 7 and 8.5 percent adjustments.

On July 3, 1975 Edison announced it had launched an additional cost reduction program designed to further cut expenses by 5 percent. A staff witness testified that the resultant savings could be on the order of $15 million a year. This was rebutted by an Edison witness who testified that preliminary studies indicated an $11 million cost reduction. We will utilize the $11 million reduction in our adopted results.

A. REVENUES

Edison's revenue estimates were presented by its assistant comptroller, Mr. R. W. Scofield, and supported by the rebuttal testimony of its supervising rate engineer, Mr. C. Hyde. The sales estimates are prepared by a committee consisting of representatives from Edison's Comptrollers, Communications and Energy Management's Staff Services, Customer Service, and Revenue Requirements Departments, the System Operation Division of the Power Supply Department, and the Electric System Planning Division of the System Development Department. The kwhr sales and number of customer estimates developed by this committee are given to the Revenue Requirements Department which, based on past recorded data, develops the estimated future revenues by both rate schedules and revenue classifications.

Edison's latest sales and revenue forecasts reflect estimates resulting from such a committee meeting held on February 18, 1975. These estimates generally reflected lesser revenues, sales, and customers than the original estimates included with the application because of the effect of the general deterioration of the economy.

Mr. Hyde, in his rebuttal testimony, testified that in spite of the fact that both the staff and Government had later recorded data than Edison at the time their estimates were prepared, Edison's estimates were the more accurate ones because neither the Government's nor the Commission staff's witnesses properly considered the effect of such factors as changes in customer's utilization of equipment, discontinuance of Edison's promotional activities, the present emphasis on conservation, and the current high level of Edison's rates.

Commission Staff's Revenue Estimates

The Commission staff's engineer testified that the staff initially delayed its independent forecast of kwhr sales and revenues until it was able to consider one full year's experience under our conservation orders issued as a result of Case No. 9581, our investigation of the energy and fuel requirements of electric public utilities. As a result, the basic projections he used for the 1975 and 1976 estimates reflected recorded data for 1974 through April 1975. Estimates were prepared by rate schedules and the overall reasonableness of the estimates were verified by estimates prepared by revenue classification. According to the testimony of this witness, the downward trend of sales which predominated the 1974 recorded data reversed itself for all classes of service except industrial and resale as of December 1974. In addition, as of the date of his testimony (August 1, 1975) it appeared to him that the industrial sales trend had bottomed out but he would need later data to verify this fact.

Government's Revenue Estimates

Mr. D. J. Reed, a consulting engineer, appearing on behalf of Government, presented testimony and exhibits setting forth estimated 1976 test year sales, revenues, and customer bills by rate schedules for domestic Schedules D-1 through D-6 and general service Schedules A-1 through A-8.

In general the method utilized for the preparation of the domestic schedules consisted of projecting, by rate schedules, the recorded number of customers adjusted for zone changes and condemnations and the average usage per customer. Mr. Reed's review of the consumption patterns led him to the conclusion that conservation efforts resulted in depressing the kilo-

watt-hour usage per customer during the year 1974 but that the domestic customers are renewing their full consumption patterns. He, therefore, applied the long-term growth rate (1967-1973) to the June 1975 recorded usage to obtain his 1976 test year estimated kilowatt-hour per customer per month. As an alternate calculation, Mr. Reed applied the Commission staff's estimate of kwhr per customer bill to his estimates of customer bills. The revenue was computed by the application of Edison's bill frequency analysis to his estimates of sales by rate schedules.

Mr. Reed's estimates of general service Schedules A-1 through A-6 differ from both the Commission staff's and Edison's estimates in that his estimates separately considered single-phase and three-phase customer use characteristics. Such analysis indicated to him that there is a trend underway for customer movement from single phase to three phase and from Rate A for small customers to the demand Rate B for larger customers. Mr. Reed believes his more detailed, and therefore more accurate, estimates should be adopted in preference to the other estimates.

Mr. Reed also testified that his large power Schedule A-7 and very large power Schedule A-8 should be adopted in preference to the other estimates because they are based on later data.

Comparison of Estimates

The following tabulation taken from the staff's Exhibit 60 and Government's Exhibit 79 summarizes the differences in Edison's and the Commission staff's estimates by revenue class and/or by rate schedules for the test year 1976, together with our adopted results. The bases for the adopted amounts are set forth in the following paragraphs:

Comparison of Estimates
Of Operating Revenues, Sales,
And Number of Customers

Item	Edison	Staff	Government	Adopted
	Average Customers			
Residential	2,453,862	2,461,703	NA	2,461,703
Agricultural	24,742	24,850	NA	24,850
Commercial	224,166	224,386	NA	224,377
Industrial	30,095	30,090	NA	30,090
Public Authorities	32,889	32,872	NA	32,872
Interdepartmental	2	2	NA	2
Resale	18	18	NA	18
Total	2,765,774	2,773,921		2,773,912
	Sales (Millions of Kwhr)			
Residential	13,680.0	14,660.0	NA	14,000
Agricultural	1,100.0	1,100.0	NA	1,280
Commercial	12,170.0	12,330.1	NA	12,880
Industrial	16,150.0	16,100.0	NA	15,650
Public Authorities	6,010.0	6,173.1	NA	5,700
Interdepartmental	1.5	1.5	NA	1
Resale	4,350.0	4,209.5	NA	4,210
Total	53,461.5	54,574.2		53,721

Comparison of Estimates
Of Operating Revenues, Sales,
And Number of Customers
(Continued)

Item	Edison[1]	Staff	Government	Adopted
	(Dollars in Thousands) Revenues (Excluding FCABF Revenues)			
Residential	$ 441,832	$ 463,637	NA	$ 449,962
Agricultural	27,200	27,300	NA	30,255
Commercial	301,120	304,475	NA	311,005[2]
Industrial	258,900	259,500	NA	253,860[3]
Public Authorities	113,082	117,082	NA	112,508
Interdepartmental	45	45	NA	27
Resale	66,029	64,553	NA	64,553
Other Oper. Revenue	10,713	10,713	NA	10,713
Total	$1,218,921	$1,247,305		$1,232,883

[1]The estimates assigned to the utility were developed by the staff from information provided by Southern California Edison Company.

[2]Includes Government's Schedule A-7 revenue computations.

[3]Includes Government's Schedule A-8 revenue computations.

Because of the size of Edison's operations the small percentage differences in the sets of estimates are represented by rather respectable sales and revenue figures. Government's estimates are based on recorded data for the period ended June 30, 1975. Mr. Reed testified that the recorded data for July and August 1975 supports the accuracy of his estimates when consideration is given to the reduction in air conditioning requirements that accompanied the relatively cool summer of 1975. According to the record, 1975 was cooler than average, 1974 was approximately average, and 1973 was warmer than average and the peak megawatt demands on the Edison system were less for 1974 than for 1973. The decrease in demand for the summer of 1974 is attributable in part to the decrease in cooling requirements and in part to the effect of conservation practices. From the record it appears that, at least insofar as domestic and small general service customers are concerned, conservation efforts are declining and the average consumption per customer is on the increase, although at a lesser extent than in the preconservation era.

For the test year 1976 Edison estimated a total of 29,592,000 customer bills for Schedules D-1 through D-6 as compared to 29,709,600 for the Commission staff and 30,108,981 for Government. On an overall basis this difference is less than 2 percent between Government and Edison and less than one-half percent between the Commission staff and Edison. It should be noted, however, that these differences represent a substantial difference in the number of domestic customers to be added during the year 1976. In his rebuttal testimony, Mr. Hyde noted that in the first six months of 1975 the average number of domestic

customers increased 21,542. He further testified that during this same period building permits were issued for only 16,243 family units in Edison territory. These statistics confirm, in his opinion, Edison's estimates of 40,039 new customers per year in contrast to the staff's estimate of 46,572 new customers and Government's estimate of 68,760 new customers. Another difference reflected in these three estimates is the number of customer bills for each rate level. Government's consultant testified that he adjusted recorded data to reflect zone changes and condemnations before making his projections, whereas both the Commission staff's and Edison's witnesses made their projections from unmodified data on the basis that zoning was an ongoing occurrence and zone changes were thereby reflected in projections of recorded data. The recorded data used by Edison in support of its estimates reflect recessionary conditions. The steadily improving economy coupled with the pent-up demand for housing should result in more new housing than projected by Edison but not as much as projected by Government. We will therefore adopt the staff's estimate of new customers together with its apportionment to the various rate levels.

For general service Schedules A-1 through A-6, Mr. Reed separately estimated single-phase and three-phase-bill months and kilowatt-hours-per-bill month for Rate A and Rate B of the general service schedules. Such a method of estimating is, according to his testimony, more accurate than either Edison's method of estimating Rate A and Rate B as a whole or the staff's method of estimating by rate schedules as a whole and should, therefore, be adopted in preference to the other two estimates.

Mr. Hyde's rebuttal testimony reflected estimates based on later recorded data than used by Mr. Reed. This data led Mr. Hyde to the conclusion that there is a continuation of most of the conservation practices previously adopted by Edison's customers and that the sharp increases authorized for charges for electric service during the last few years encourages continued and additional customer conservation. He further testified that numerous contacts by Edison energy service consultants with general service customers was expected to achieve further reductions in energy consumption by the small general service customers. Based on these factors, Mr. Hyde concluded that Edison has slightly underestimated 1976 sales on Rate A and overestimated Rate B and total sales.

From our independent review of the record we cannot say that one sales estimate or another is persuasive. We will adopt a sales estimate in total somewhat higher than Edison's. We will adopt the staff's customer estimate.

B—EXPENSES

General

Testimony and exhibits of estimates of 1976 test year expenses were presented by Edison and the Commission staff. Excluding the following discussed items, the differences between Edison's and the staff's estimates were small and were generally caused by differences in estimating procedures. The staff's engineers utilized one or more of the following generally accepted estimating methods: average annual change in recorded expenses, least squares trend of total expenses, separate least squares trend of expenses, separate least squares trends of labor and nonlabor components adjusted for in-

creases, and the application of judgment to arrive at a composite of several of these methods.

Edison's estimates are based on budgeted amounts reflecting prior history and anticipated future work adjusted, where deemed appropriate, to reflect the latest available information. Both methods, properly applied, can produce valid estimates. We will, therefore, average the two estimates for items reflecting relatively minor differences recognizing that in terms of our adopted rate base, a change of approximately $775,000 is required to effect a change of 0.01 percent in the rate of return.

Production Expenses—Fuel and Purchased Power

Testimony on these matters was presented on behalf of Edison by its assistant manager of the Systems Operation Division of the Power Supply Department, Mr. M. H. Kent, and, as previously stated, on behalf of the Commission staff by associate utilities engineer, Mr. H. J. Lindenmeyer.

The component parts of these expenses are the total kilowatt hours of energy that must be provided, the average year availability and cost of hydrogeneration and purchased power, the unit cost and availability of the various fuels, and the heat rate to be obtained by the various thermal generating units.

Edison derives the total kilowatt hour generating requirement by independently estimating the annual system sales and the required kilowatt hours to be transmitted from generating stations and other sources. The difference between these estimates represents losses, billing lag, and company use. The correlation between sales and transmitted energy thus obtained is compared

for reasonableness with computed conversion factors. The computed conversion factor developed by Edison for the test year 1976 is .925. The staff's engineer used the average of five years recorded data for the period ending 1974 to develop a conversion factor of 0.927. We will adopt this latter figure as being more representative of average year conditions. Applying this conversion factor to our previously adopted sales of 53,721 millions of kwhrs results in a total Edison main system net requirement of 60,642 millions of kwhr.

The production resources available to Edison for fulfilling this requirement consist of company-owned hydroelectric, fossil-fueled steam, diesel, and gas turbine electric plants; jointly-owned fossil-fueled and nuclear-fueled steam-electric plants; and purchased power available from other utilities, DWR, U. S. Bureau of Reclamation, the Bonneville Power Administration, and others.

The following tabulation compares by energy sources, Edison's and the staff's estimates together with the adopted results. It will be noted that the total energy to be transmitted is 60,466 M^2kwhr as estimated by Edison and 61,543 M^2kwhr as estimated by the Commission staff, a difference of 1,007 M^2kwhr or 1.78 percent. Assuming that 620 kilowatt hours can be generated per barrel of oil and assuming a price of oil of $15.87 a barrel, the cost differential reflected by Edison's and the staff's estimates is approximately $25,776,000.

Comparison of Relative Energy
Sources Availability Estimates

Energy Source	Edison	Staff	Adopted[1]
		(M²kwhr)	
Sales to Other Co.	1,493	1,493	1,183
Interchange, etc.	1,655	1,655	1,655
Purchased Power			
Canadian Entitlement	576	576	576
Oroville-Thermalito	879	879	879
Navajo Layoff	1,585	1,585	1,585
BPA Surplus	1,322	1,325	1,325
Edison Hoover	255	266	266
Economy Purchases	611	664	664
Pre-release, (Long Beach)	270	270	270
Subtotal—Purchased Power	5,498	5,565	5,565
Edison Hydro	4,357	4,474	4,357
Nuclear	2,372	2,378	2,378
Gas and Oil Units			
Gas	438	509	509
Oil	35,318	36,134	35,660
Oil Pipeline & Storage	—	—	—
Subtotal	35,756	36,643	36,169
Coal Units			
Coal	9,082	9,082	9,082
Gas	253	253	253
Subtotal	9,335	9,335	9,335
Total Energy	60,446	61,543	60,642
Co. Generated	53,313	54,323	53,422
Fuel	48,946	49,849	49,065
Fossil Fuel—Excl. off-system	48,946	49,849	49,065
Fossil Fuel Total	46,584	47,471	46,687
Total Gas	691	762	762

[1]Bases for adopted figures set forth in the ensuing paragraphs.

After review and independent analysis the Commission staff adopted Edison's estimate of 1,493 million kwhr sales to other companies. The staff's updated heat rate of 9,817 Btu's per kwhr for gas and oil fuel was applied to the base unit costs of 101.59 cents per million Btu's established by Decision No. 81919 to yield fuel costs of $14,890,000 for this cate-

gory as compared to Edison's computed figure of $39,729,000 derived from the product of a heat rate of 9,897 Btu's per kwhr and a forecast unit cost of 268.86 cents per million Btu's. The staff also adopted Edison's interchange estimate of 1,655 million kwhr transmitted at a cost of $655,000 and its estimates of energy transmitted from coal units of 9,335 million kwhrs. For the coal units, the staff's use of updated heat rates and the base unit costs established by Decision No. 81919 resulted in a 1976 test year-estimate of $19,226,000 as compared to Edison's estimate of $21,565,000. Edison estimated the average test-year fuel requirements by use of a computer program simulating the integration of system resources. The test-year unit loading and fuel requirements were based on generation designed to produce minimum emission of oxides of nitrogen from all of its fossil-fueled thermal plants in the South Coastal Air Basin. Edison used its supplier's estimates of average temperature gas fuel availability priced at the supplier's rate schedule. The fuel oil prices used in the computation were based on a monthly system unit price determined by using an average-year burn rate applied to the recorded oil inventory as of October 1 prior to the year for which the prices were developed. In our opinion the staff's estimate of sales to other companies is high. We have adopted the amount of 1,183 M²kwhr as the sales to other companies and have adjusted the staff's estimates accordingly (see table on page 38). [App. p. 34.]

We will adopt the staff's estimate of total kilowatthour energy requirements adjusted for our adopted sales estimates and loss factor. We will adjust the staff's fossil fuel generation requirements to reflect the

subsequently discussed adopted hydrogeneration quantities. As previously stated we will utilize the unit fossil fuel costs reflected in Decision No. 81919 in our adopted results of operations and for the computation of revenue requirements.

Known unit costs of purchased power and nuclear fuel as of January 1, 1975 were used by both the staff and Edison. The staff used the average of the latest 15 years of recorded kwhr production from the three divisions for estimating Edison's own hydroproduction whereas Edison based its estimates on an analysis of recorded hydrological conditions utilizing 53 to 55 years of data. Edison's estimates of its own hydroproduction will be adopted.

The staff's estimate of Hoover generation is based on the latest ten years of recorded kwhr received whereas Edison's estimate of Hoover generation approximates the average generation for the period 1972-1975. The staff's estimate, based on the longer time span, will be adopted.

For economy energy purchases, Edison used available 49-months recorded data with the intention of deriving future average purchases from a 60-month base of recorded data as such data becomes available. The staff used a 60-month average consisting of 51 months of recorded data and nine months current outlook projection through December 1975. The staff's estimate, approximating Edison's eventual base data period, will be adopted.

Both Edison and the staff used a 60-months average of recorded data for estimating the availability of Pacific Northwest surplus energy. The staff's estimate, based on a later 60-months period, will be adopted.

After review of Edison's work papers and an independent evaluation of available data, the staff adopted Edison's estimates of Canadian Entitlement, Oroville-Thermalito generation, Navajo layoff, and Long Beach pre-release generation quantities.

The following tabulation summarizes the adopted quantities and expenses by energy sources.

Energy Source	Quantity M^2 — kwhr	Expense M — $
Sales to Others	1,183	$ 11,799
Interchanges	1,655	655
Purchased Power	5,565	38,330
Edison Hydro	4,357	—
Nuclear Power	2,378	3,397
Gas and Oil	36,169	321,667
Coal	9,335	21,283
Fuel Service Charge	—	1,284
Total Fuel and Purchased Power	60,642	398,415

Production—Excluding Fuel and Purchased Power

These expenses include power production operation and maintenance expenses for steam, hydraulic, nuclear, and other power generation.

With the exception of other power generation operation and maintenance expenses, Edison's estimates of production expense, including fuel and purchased power, presented by its manager of power supply, Mr. J. T. Head, Jr., closely approximate the staff's estimates presented by Associate Utilities Engineer G. J. Hobbs. The discrepancy in other power generation operation and maintenance expense estimates relate to the inclusion period for the Long Beach combined cycle plants. Edison used six months labor and a full years' material, overhead and indirect expenses as contrasted with the staff's utilization of three months' expenses based on a composite operational date of the plant of October

1, 1976. The record shows that the plant consists of seven 63 MW turbines that are scheduled for operation between July 2, 1976 and December 17, 1976, an 82 MW steam turbine scheduled for operation September 24, 1976, and one 49 MW steam turbine scheduled for operation on December 17, 1976. Under these circumstances, the staff's treatment of the Long Beach combined cycle steam generating units appears reasonable and will be adopted. The tabulation on the following page [below, this page] sets forth the 1976 test year total power production expenses as estimated by Edison and the Commission staff together with the adopted test year expenses.

Item	CPUC Staff	Edison	Adopted
	(Dollars in Thousands)		
Steam			
Fuel*	$356,686	$349,760	$353,660
Operation	24,019	24,208	24,114
Maintenance	40,698	31,198	40,948
Total Steam	$421,403	$415,166	$418,722
Hydraulic			
Operation	$ 3,687	$ 3,696	$ 3,692
Maintenance	3,567	3,705	3,636
Total Hydraulic	$ 7,254	$ 7,401	$ 7,328
Nuclear			
Fuel	$ 3,397	$ 3,388	$ 3,397
Operation	4,612	4,700	4,656
Maintenance	2,184	2,228	2,206
Total Nuclear	$ 10,193	$ 10,316	$ 10,259
Other Power Generation			
Fuel*	$ 3,028	$ 3,912	$ 3,028
Operation	1,201	1,555	1,201
Maintenance	1,193	1,658	1,193
Total Other Power Generation	$ 5,422	$ 7,125	$ 5,422
Purchased Power	$ 38,985	$ 38,293	$ 38,330
Total Power Production Exp.	$483,257	$478,301	$480,061

*Fuel at base unit cost and fossil fuel mix.

Transmission Expenses

Edison's presentation of these expenses was made by Mr. Head and the staff's presentation was made by Mr. Hobbs. With the exception of Account 570, Maintenance of Station Equipment, the differences between Edison's and the staff's estimates were relatively small. Edison's estimate of Account 570 exceeds the staff's by $297,000 due primarily to the difference in allowance for contingencies of $600,000 by Edison and $300,000 by the Commission staff. The record shows that staff's estimate more closely approximates actual recorded data and it will be adopted. The following tabulation summarizes Edison's and the staff's estimates together with the adopted expense for the test year 1976:

Item	Staff Estimated	Edison Estimated	Adopted Results
	(Dollars in Thousands)		
Transmission Operation	$22,389	$22,523	$22,456
Transmission Maintenance, excluding Account 570	9,298	9,268	9,283
Account 570, Maintenance Station Equipment	5,560	5,857	5,560
Total Transmission Expense	$37,247	$37,648	$37,299

Distribution Expenses

Exhibits and testimony on distribution expenses were presented on behalf of Edison by its manager of staff services Mr. W. R. Dougher and on behalf of the Commission staff by Mr. Hobbs.

In this category of expenses, the major differences between Edison's and the staff's estimates was in Account 583, Overhead Line Expense. This account includes the expenses attributable to Edison's transformer

load management program (TLM) which is intended to provide standards for fully loading new transformers and replacing existing, overloaded transformers. Such a procedure is anticipated to effect savings by a reduction in the purchase of new transformers and the elimination of expensive service interruptions due to burned out transformers. The record shows that the program was accelerated over what was originally planned to provide work for approximately 60 construction workers who would otherwise have to be laid off because of a decline in plant construction. The budgeted amounts for the TLM program are $1,-090,000 for 1975, $1,450,000 for 1976, $1,380,000 for 1977, and $570,000 for 1978. Edison used the 1976 budgeted amount for the test year whereas the staff based its estimate on the average TLM expense for the four year period. The staff's approach appears reasonable and will be adopted. The following tabulation compares Edison's and the staff's estimates and the adopted results.

Item	Staff Estimate	Edison Estimate	Adopted Results
	(Dollars in Thousands)		
Distribution Operation Excluding Account 583	$26,525	$27,064	$26,795
Account 583, Operation Overhead Lines	4,626	5,033	4,626
Distribution Maintenance	32,859	33,652	33,256
Total Distribution Expense	$64,010	$65,749	$64,677

Customers' Accounts Expenses

Edison's presentation for this group of expenses was made by Mr. Dougher and the staff's presentation was made by Mr. Hobbs. Except for Account 904, Uncollectibles, the differences in estimates were relatively small. Edison's estimate for uncollectibles was

predicated on the estimated amount necessary to maintain the reserve at a level approximating one-year's estimated net write-offs, or about 0.31 percent of revenue to be derived from ultimate customers whereas the staff used the recorded average percent of revenue write-off of 0.2867 percent for the five-year period 1969 through 1973. The staff witness accepted, subject to check, that if the 1974 recorded amount had been included in the computation, the five-year average would be .297 percent and testified that had the data been available at the time he had prepared his estimate he would have used the figure for his estimate. We will therefore adopt this figure which applied to the previously adopted revenues yields a 1976 test year uncollectible expense $3,421,000 at base rates.

The following tabulation compares Edison's and the staff's estimates and the adopted customer's accounts expense.

Item	Staff Estimate	Edison Estimate	Adopted Results
	(Dollars in Thousands)		
Customer Accounts Expense, Excluding Account 904	$27,298	$27,608	$27,453
Account 904, Uncollectible Accounts	3,464	3,408	3,421
Total Customer Accounts Expense	$30,762	$31,016	$30,874

Sales Expenses

Testimony and exhibits on the subject of sales expenses were presented on behalf of Edison by one of its vice presidents, Mr. E. A. Myers, Jr., on behalf of the Commisson staff by Mr. Hobbs, and on behalf of TURN by the head of an advertising and public relations business, Burt Wilson

Edison's vice president testified that sales expenses have historically been incurred to enhance the selective

acquisition and programming of loads which would increase the system load factor with resultant benefits to ratepayers. However, according to his testimony, in recent years, due to the possibility of a shortage in generation capacity, the marketing emphasis was shifted to moderate the rate of growth in consumer demand and set the stage for a stronger energy management effort. Because of this change in direction and emphasis, Edison believes the titles and description of the various sales expense accounts set forth in the uniform system of accounts inapplicable and refers to the category as "Energy Management Expenses" and the individual accounts as "Supervision", "Customer energy management contracts", "Energy management advertising", and "Miscellaneous expenses" rather than "Sales expenses", consisting of "Supervision", "Demonstration and selling expenses", "Advertising expenses", and "Miscellaneous sales expenses" presently used. A change in account titles at this time could result in confusion and would not make such expenses more palatable to those opposed to saddling the ratepayer with any advertising or customer contact expense irrespective of its purpose. Consequently, it would serve no useful purpose to establish the nomenclature espoused by Edison. Edison's test year 1976 sales expense (energy management) estimates total $1,984,000 and consist of $47,000 supervision, $1,105,000 in Account 912 (Demonstrations and Selling Expenses) and $832,-000 in Account 913 (Advertising Expenses). According to the testimony, the major expenses included in Account 912 are for personnel contacting commercial, industrial, agricultural, and public authority customers to urge a reduction in over-all energy use; labor and expenses for residential energy services personnel to

contact major new construction developers to urge the installation of adequate levels of insulation materials and to recommend changes in design construction techniques to achieve energy conservation; labor and expenses for consumer services personnel in advising residential customers of methods to reduce energy consumption; and labor and expenses of staff personnel to monitor and support the above. According to this witness's testimony, Edison included in Account 913 only the minimum amount of advertising expense required to effectively communicate energy management messages to the approximately 7,500,000 people served throughout its service territory. The record shows that $265,-000 of the recorded advertising expense incurred during the year 1973 resulted from our first interim order in Case No. 9581. Mr. Myers testified that, in his opinion, an increase in planned expenditures for achieving conservation was necessary because of the general de-emphasis of the need to conserve resulting from the end of the oil embargo. The amount Edison budgeted for media advertising in Account 913 for the years 1974, 1975, and 1976 was $800,000.

The amount of informational advertising carried under Administrative and General Expenses in Account 930, Miscellaneous General Expenses, was also included in Mr. Myers' presentation. The recorded informational advertising expense for 1974 was $22,704 of which $10,000 was spent for kite safety messages and $12,704 was spent for financial advertising. The budgeted amount for 1975 was approximately $700,000 and consisted of kite safety—$10,000, environmental protection measures—$100,000, discussion of viable future energy sources—$150,000, financial communications—$40,000, and plant safety and siting advertising—$400,-

000. For 1976 the budgeted amount for institutional advertising was increased to $1,000,000 to reflect an increase of $300,000 in the budgeted amount for advertising relating to plant siting and safety.

The Commission staff engineer's basic position on the level of sales expense to be included as media advertising in Account 913 is that the peak in energy conservation efforts, including consumers education advertising pursuant to this Commission's three interim orders in Case No. 9581 should have occurred in 1974 and that the level of expense could be expected to be less for 1975 and 1976 than was incurred in 1974 and late 1973. On this basis, the staff's estimate for advertising in support of energy conservation has been set at $572,000 for 1975 and 1976. The full amount budgeted by Edison for conservation advertising will be allowed. After independent study and evaluation, the staff's engineer adopted Edison's revised 1976 test year estimates for Accounts Nos. 911 and 912. We will, therefore, adopt these agreed upon amounts for Accounts Nos. 911 and 912.

Senior Utilities Engineer A. V. Day testified on Administrative and General Expenses including the reasonable expense for informational advertising to be included for rate-making purposes in Account 930. He testified that the specific expense under discussion was advertising to facilitate an adequate future supply of electric energy through factual discussions of plant siting, safety, and environmental impact as set forth on mimeo page 39 of Decision No. 81919. He noted that the recorded per customer expense for this type of advertising was 80 cents in 1971, 56 cents in 1972, and 35 cents in 1974. Extrapolation into 1976 resulted in a per customer expense of 16 cents which

multiplied by the estimated number of customers resulted in his estimated expense for this kind of advertising of $350,000. The 16 cents per customer cost was, in his opinion, quite comparable to the 20 cents per customer budged by PG&E and, therefore, justifies its adoption.

TURN's consultant testified to his belief that the only advertising that should be permitted at the ratepayer's expense is advertising associated with financial offerings. He stated that because Edison operates a monopoly utility service without competition in its service area there is no compelling need to advertise other aspects of its program. This witness further testified that while we must all adopt a conservation ethic, it would be more appropriate for public entities who are responsible for establishing policy in this area to be the source of any programs to encourage conservation and cited, as an example, the advertising program initiated by the Federal Energy Administration. Under cross-examination he stated his belief that the public would be more likely to accept such statements from a public official such as a governor of a state than from the utility or even a state agency. He further questioned public acceptance of conservation advertising disseminated over the same media that formerly advocated increased usage of electricity. He stated his opinion that bill stuffers are an excellent means of advertising, but that the quality of bill stuffers currently being used is in need of improvement. This witness recommended that we disallow for rate-making purposes all expense items relating to public relations including that portion of salary and expense of local, district, and division managers and ancillary staff devoted to

public relations functions, on the basis that such activities are self-serving and image-building and are, therefore, an inappropriate burden to be thrust upon Edison's customers.

We have reviewed the Commission's discussions of advertising and public relations expenses in recent decisions. (*Re PG&E*, Decision No. 84902 dated September 16, 1975 in Application No. 54279; *Re PG&E*, Decision No. 86281 dated August 24, 1976 in Application No. 55509; *Re SoCal Edison*, Decision No. 81919 dated September 25, 1973 in Application No. 53488.) The most detailed discussion of these expenses occurs in Decision No. 84902. In order to restate our position regarding the allowance of such expenses, we review the discussion in Decision No. 84902 and clarify it here.

First, with respect to advertising, in Decision No. 84902 the Commission disallowed all of PG&E's expenses for institutional advertising. We did allow for ratemaking purposes expenses for energy conservation and customer service advertising. Furthermore we asserted:

> "Bland and general conservation advertising may simply be another form of institutional advertising and should not be charged to ratepayers. Specific, useful information about conservation . . . can be of great use to individual customers and can reduce costs for the system as a whole." (At p. 82.)

This continues to reflect Commission policy toward advertising, which can be summarized and emphasized as follows:

> All institutional advertising shall be disallowed for ratemaking purposes. Furthermore, all other advertising, except that which is listed below, shall also be disallowed for ratemaking purposes.
>
> a. Financial advertising.
>
> b. Safety messages.
>
> c. Essential customer services information such as changes in location of offices, telephone numbers, payment agencies, and announcements of regulatory proceedings before this Commission or other regulatory agencies.
>
> d. Results-oriented, specific conservation advertising; this must, however, be accounted for separately as a conservation expense.

In regard to advertising, informational advertising expense of $10,000 for kite safety messages and $40,000 for financial advertising, or a total of $50,000, is appropriate in this rate case.

Second, with respect to public relations, the Commission stated in Decision No. 84902:

> "PG&E is placed on notice that it shall be the policy of this Commission henceforth to exclude from operating expenses for rate fixing purposes all amounts claimed for public relations expense for which it cannot be shown:
>
> "a. Provides normal liaison with, and channels of communication for, representatives of the press, radio, television, and other media.
>
> "b. Results in reduction of operating costs and more efficient service to the ratepayers.
>
> "c. Encourages the more efficient operation of the utility's plant, the more efficient use of

the utility's services, or the conservation of energy or natural resources, or presents accurate information on the economical purchase, maintenance, or effective use of electrical or gas appliances or devices.

"d. Presents factual discussion of specific topics dealing with plant siting, safety, and environmental impact.

"In future proceedings involving this and other utilities, we shall expect the utility to justify, and our staff to verify, public relations costs in detail and to supply, for the record, information on each aspect of the utility's public relations program so that we may make judgments regarding the reasonableness of each activity and of appropriate reasonable allowances." (At p. 84.)

We shall clarify the above as follows:

a. *Minimal* staff shall be available to respond to inquiries into utility activities from the communications media.

b. Reasonable expenses for customer services activities shall be allowed for ratemaking purposes. These shall include provision of essential customer service information (such as notification of changes in office locatins, telephone numbers, payment agencies, or regulatory proceedings before this Commission or other regulatory agencies). These should, however, be explicitly accounted for and allocated where appropriate.

c. Point c reflects PUC Code Section 796(b). We interpret this as pertaining to energy conservation expenditures which should be strictly and explicitly conservation related and should be accounted for separately as conservation expenses.

d. Expenses reflected in Point d shall *only* be allowed for ratemaking purposes if they are for responses to specific requests for information from the communications media or from the general public or if they are to inform the public of regulatory proceedings before this Commission or other regulatory agencies. Site tours shall not be allowed for ratemaking purposes.

e. We repeat with emphasis our admonition that all public relations expenses should be described and justified *in detail* by utilities and their appropriateness verified by our staff in all future rate proceedings.

On the ninety-eighth day of hearing on this matter, Mr. Myers presented an additional exhibit setting forth a plan directed towards the achievement of the objective of maintaining and/or improving Edison's conservation results through a broadening of its energy management programs. This exhibit outlined five new major programs which Edison estimates could lower the anticipated future annual sales by as much as 180,000,000 kilowatt-hours for residential and 130,000,000 kilowatt-hours for commercial customer groups at a reduction in revenues, including a fuel adjustment at total fuel costs, of $15,900,000 and a reduction in operating costs of $9,200,000. Excluding fuel adjustment, the corresponding reduction in revenues is $9,200,000 and in operating expenses $3,500,000. The additional programs are estimated to cost $2,400,000

resulting in a net impact in revenue deficiency excluding fuel adjustment of $8,100,000. This witness' testimony indicated Edison's belief that these proposed expanded energy management programs are timely in view of the newly announced programs of various state and federal agencies and should be implemented through appropriate expense allowances.

The five programs consist of (1) escalating contacts by energy services personnel with general service customers, (2) the installation of shower flow regulating devices, (3) expanded conservation publicity releases, (4) the furnishing of energy conservation kits, and (5) the analyses of individual customer's electric energy savings potential. A common denominator to the successful implementation of these various programs is the cooperation and sincere desire of the customers to effect such conservation measures. The Commission's newly formed Energy Conservation Team recommends the adoption of Edison's supplemental program. The team intends to monitor the effectiveness of Edison's conservation programs carefully. We will recognize the additional conservation expense of $2,400,000 and have recognized the reduced sales levels which in the longer term will result in more economic service to California customers.

In subsequent proceedings, a more detailed analysis will be undertaken and Edison's rate of return will be adjusted, upward or downward, as the evidence indicates. In connection with the filing of its 1977 conservation programs Edison shall clearly detail its various conservation advertising expenses.

Edison shall perform follow-up studies to determine the effectiveness of its conservation programs and shall inform the Commission of the results. Included shall be an assessment of the degree and effectiveness of efforts to distribute information and market conservation hardware, with estimates of cost effectiveness and resulting energy savings. Justification shall be provided for relative emphasis among media for information transfer, among efforts directed toward behavior change as compared with hardware, and among various hardware options promoted.

Edison should also take the initiative to develop and bring before the Commission programs of incentives, including but not limited to subsidies, low-interest loans, and modified rates, for inducing conservation-oriented behavior and investment by end users.

The Energy Conservation Team shall review these programs and advise the Commission of any action which would be appropriate.

Administrative and General Expenses

Tabulated below are Edison's and the Commission's staff's 1976 test year estimated administrative and general expenses together with the adopted results. Edison's presentation was made by Mr. Scofield and the staff's presentation by Mr. Dal. The bases for the adopted results are detailed in the ensuing paragraphs.

Acct. No.	Title	Test Year 1976 Staff	Test Year 1976 Utility	Utility Exceeds Staff Amount	Utility Exceeds Staff Percent	Adopted Results
				(Dollars in Thousands)		
920	Admin. & Gen. Salaries	$33,481	$35,666	$2,185	6.5%	$33,905
921	Office Supplies & Expenses	8,202	8,202	—	—	8,800
922	Admin. Expenses Trnsf.	(14,297)	(15,047)	(750)	5.2	(14,648)
923	Outside Services Employed	2,077	2,191	114	5.5	2,134
924	Property Insurance	1,470	3,134	1,664	113.2	3,017
925	Injuries & Damages	2,878	2,940	62	2.2	2,909
926	Employee Pensions & Benefits	27,475	27,813	338	1.2	27,644
927	Franchise Requirements	8,907	8,681	(226)	(2.5)	8,798
928	Regulatory Comm. Expenses	231	248	17	7.4	240
929	Duplicate Charges —Credit	(24)	(24)	—	—	(24)
930	Misc. General Expenses	9,754	11,893	2,139	21.9	9,454
931	Rents	1,007	1,007	—	—	1,007
932	Maint. of General Plant	3,887	4,328	441	11.3	4,328
	Subtotal	$85,048	$91,032	$5,984	6.6%	$87,564
	Adjm. to Public Relations Exp					(2,050)
	Total					$85,514

(Red Figure)

Administrative and general expenses include public relations expenses which have been hereinabove discussed. In the absence of complete justification by Edison of all such expenses we have allocated $750,-000 of a total of $2,800,000 for public relations for conservation, customer services, and other allowable expenses. The adjustment to administrative and general

expenses as a result of this allocation is $2,050,000. In the future the conservation expenses contained under A&G should be budgeted separately under conservation.

Edison's original estimates were based largely on the budgets and forecasts of anticipated expenses furnished in October 1973 by each department and/or division. The basic data for these estimates include prior years' expenditures and reflect anticipated changes in operations. The updated estimate of administrative and general expenses, introduced into evidence on March 20, 1975 included recorded 1974 expenses and revised 1975 and 1976 estimates. These revised estimates reflect function and manpower budget amounts prepared with the objective of maintaining 1974 controllable expenditures at or below 1973 levels, a continuation of the hiring freeze, and the utilization of applicable lay-off procedures to effect approved manpower reductions.

As a starting point in the preparation of his estimate of administrative and general expenses, the staff engineer made an analysis of the actual administrative and general expenditures made during the first ten months of 1974 which included the cost saving program commencing in February 1974. The 10-month recorded administrative and general expense of $77,054,000 was reduced $6,496,874 for the Vidal nuclear power plant and $2,000,000 of nonrecurring increases in the reserve for possible injuries and damages. The remaining $68,557,126 was further decreased to $65,000,000 to reflect probable December transfers of research and development expenses. This $65,-000,000 was used as the basic amount for the administrative and general expenses excluding franchise require-

ments and was distributed to accounts proportionately to Edison's adjusted 1974 budget. The 1975 and 1976 staff estimates were then developed to reflect expected costs savings and further ratemaking adjustments, labor adjustments, and allowances for expected increases in materials and other expenses which were applied accumulatively by accounts and by years as appropriate. The staff's final estimate was then derived from adjusting 1974 recorded data and adding to that base figure allowances for growth, inflation adjustments, and wage increases.

Accounts 920, Administrative and General Salaries, and 921, Office Supplies and Expenses, include the compensation, office supplies, and expenses of officers, executives, and other employees of the utility properly chargeable to utility operations but not chargeable directly to a particular operating function.

The staff's 1976 test year estimate for Account 920 was derived as detailed above. A downward adjustment of one-half percent was made to the approved budget figure to reflect a full year effect of the cost savings program started early in March 1974. The resulting 1974 adjusted figure was then increased for labor and growth and $50,000 for a new executive development program in 1975 and an additional $50,000 for new environmental planning functions. The total thus derived was $33,480,800 for Account 920 which was rounded to $33,481,000 or $2,185,000 less than estimated by Edison. With the exception of the $414,439 deduction for the 1½ percent further cost saving adjustment, the staff estimate appears reasonable and well-founded. We will, therefore, adopt the staff estimate plus $414,000 or $33,905,000 for Account 920, less our public relations expense adjustment.

The staff engineer testified that he adopted Edison's estimate for Account 921 because the application of the same method to estimate this account would have resulted in a higher figure than included in Edison's budget. Under cross-examination, he estimated that the use of this method would have resulted in an estimate of approximately $8,800,000. If the estimating method is reasonable for Account 920, it is reasonable for Account 921. We will, therefore, adopt the amount of $8,800,000 for Account 921, less our public relations expense adjustment.

Account 922, Administrative Expenses Transferred-Credit, represents the administrative expenses in Accounts 920 and 921 which are transferred to construction costs. Consistent with our adopted expenses for Accounts 920 and 921, we will adopt a credit of $14,648,000 for Account 922.

Account 924, Property Insurance, includes the cost of insurance of reserve accruals to protect the utility against losses and damages to owned or leased property used in its utility operation. Edison has, in general, utilized self-insurance for transmission and distribution plant, has separate insurance for its nuclear plant, has "spread-loss"[1] insurance for the first $20,000,000 (exclusive of the $500,000 deductible) of other plant, and conventional insurance for other plant between $20,000,000 and $100,000,000.

The annual premium for the spread-loss insurance is $1,430,000 of which approximately $280,000 is for administrative fees and the balance of $1,150,000 is

[1]As used by Edison the term applies to the spreading of losses over a number of years rather than its more common use of spreading losses among a number of insurance companies.

credited to an interest-bearing premium accumulator reserve which is retained by the insurance company. Losses would be paid from this reserve to the extent funds are available. If the loss exceeds the accumulated reserve, the excess would be paid by the insurance carriers and the premium would be adjusted whereby Edison would pay this excess amount plus interest over a period of up to ten years. In the event that the premium accumulation reserve reaches $9,400,000, the premium would be reduced so as to retain the reserve at that level.

The staff disallowed the spread-loss premiums on the basis that this insurance was a form of self-insurance in which there is no transfer of risk from Edison to the insurance carriers, that the same results could be obtained by Edison by depositing sums annually in its own cash accounts to cover future property losses, and that the premiums for conventional insurance for approximately the same coverage would be approximately one-half the amount paid. This disallowance of the spread-loss premium by the staff accounts for the major portion of the difference in Edison's and the staff's estimates for Account 924.

According to the rebuttal testimony of Edison's assistant treasurer and manager of insurance, Mr. W. G. Hughes, Jr., Edison implemented its spread-loss insurance for four reasons: (1) overall, the cost of premiums paid would be less and the initial premiums would be approximately equivalent to conventional insurance; (2) Edison was able to obtain $50,000,000 of earthquake coverage ($20,000,000 covered by spread-loss) at a time when it would have been difficult to have purchased even half that amount in the regular insur-

ance market; (3) greater stability in terms of a pre-established, level premium payment which is not subject to substantial changes as market conditions change; and (4) such a policy provides greater incentive to the insured to reduce risk by effective loss-preventing activities.

Mr. Hughes further testified that the conventional insurance premiums between the $20 million and $100 million coverage amounts was $425,000 which, added to the spread-loss premiums of $1,360,000 for 1973 and 1974 and $1,430,000 for 1975, results in general insurance premiums of $1,785,000 for 1973 and 1974 and $1,855,000 for 1975. This compares with recorded amounts of $469,000 for 1967, $524,000 for 1968, $582,000 for 1969, $960,000 for 1970, $876,000 for 1971, and $1,828,000 for 1972. According to the testimony, the substantial increase in the premium for 1972 over 1971 resulted from Edison's damage claims filed in 1971 as a result of the Sylmar earthquake and two substantial generating station losses which occurred in that year. It is noted that the effect of extraordinary losses occurring in one year is a substantial increase in the amount of premiums paid, not unlike the effect of such losses under the spread-loss policy to which the staff takes exception. It is further noted that the general insurance premiums for the year 1972 closely approximate the 1973, 1974, and 1975 general insurance premiums encompassing the spread-loss concept. Another facet of the spread-loss insurance which should not be overlooked is the effect of experienced losses on the amount of premiums paid. Within the limits of the insurance company's administrative costs and the balance in premium accumulation

reserve, the premiums track experienced losses. It appears, therefore, that the insurance plan used by Edison is not at odds with appropriate ratemaking considerations. Consequently, for this proceeding, we will adopt $3,017,000 for Account 924, consisting of the staff's estimate of $1,470,000 plus $1,430,000 spread-loss premium, plus one-half of the difference between Edison's and the staff's estimates excluding the spread-loss premium, as a reasonable operating expense for Account 924. In passing, we note that this amount is less than the $3,454,000 amount found reasonable for the 1973 test year in Decision No. 81919.

Account 927, Franchise Requirements, is computed by the application of a formula that relates franchise requirements to revenues. Both Edison and the staff used the same formula with the differences in estimates resulting from the inclusion of fuel clause adjustment revenues by Edison and not by the staff. We will apply this formula to the previously discussed adopted revenues to derive a 1976 test year expense for Account 927 of $8,798,000.

Account 930, Miscellaneous General Expenses, consists of general management expenses not provided for elsewhere and includes such items as dues and donations, labor and expenses for experimental and general research work, and informational and goodwill advertising. The major differences between Edison's and the staff's estimates are nonlabor and include the following staff deletions: (a) $500,000 of dues and donations; (b) Huntington Beach write-off of $547,000; (c) Vidal nuclear plant write-off of $865,000; and (d) $652,000 of Edison's estimated informational advertising expense of $1,000,000.

The staff made an item-by-item analysis of dues and donations and excluded, in a total amount of $500,000, those deemed to be nonqualifying in line with Commission policy since this Commission's decision in *Pacific Telephone and Telegraph Co.* D.67369, C.7409 (1964) 62 CPUC 775 at 851, as upheld by the California Supreme Court in *Pacific Tel & Tel Co. v Public Utilities Commission* (1964) 62 Cal 2d 634 at 668. There the Commission declared a future policy of excluding dues, donations, and contributions by a utility from operating expenses for ratemaking purposes. Upon review, the California Supreme Court expressly held that the policy adopted by the Commission to exclude such contributions from operating expenses for rate fixing purposes is correct. (*Pacific Tel. & Tel. Co. v Public Utilities Commission*, supra, at 669.) We will adopt the staff's figure for this item.

The staff's exclusion of $547,000 from Account 930 and its inclusion as a "Special Amortization" in the summary of earnings has no ratemaking effect. This amount is the annual amortization charges for the abandonment of Units 6 and 7 at Huntington Beach Power Plant. It was transferred out of Account 930 to the summary of earnings to reflect the after taxes effect of this special amortization.

Unlike the Huntington Beach Power Plant write-off the staff's witness excluded from Account 930 and did not include elsewhere an $865,000 amoritization write-off for the Vidal nuclear generating station. He testified that data on the cost savings of the abandonment procedure was unavailable at the time he prepared his estimate so he was unable to determine whether

or not it was a prudent abandonment. An Edison witness presented rebuttal testimony on this matter to the effect that: (1) Edison cancelled its contract with General Atomic Company for two 770 megawatt High Temperature Gas-Cooled Reactors (HTGR's) on July 31, 1974; (2) it was stated that customer energy conservation efforts would enable Edison to defer by three to five years the planned operating dates for the units; (3) the time delay would permit the engineering design of relatively more economical 1,500 MW HTGR's for the Vidal location; and (4) General Atomic announced that they would "not undertake any commercial commitments for the HTGR for the time being." We have evaluated the record on this matter and are unable to conclude that Edison has met its burden of proving that this expense ought properly to be borne by its ratepayers. We will, therefore, disallow any inclusion of the Vidal write-off as an expense item for ratemaking purposes.

Our adoption of $50,000 in Account 930 for informational advertising has been previously discussed under sales expenses.

The difference between the staff's and Edison's estimates for Account 932, Maintenance of General Plant, is $441,000 or 11.3 percent. The difference derives from the amount of maintenance to be incurred during test year 1976 for Edison's new Rosemead Computer Center. The record shows that the building was occupied in late 1974 and the staff's estimate reflects only the recorded partial year 1974 expense increased by one percent per year. We will adopt Edison's estimate for this account.

Taxes, Other Than Income

These expense items consist of ad valorem or property taxes, miscellaneous taxes, and payroll taxes. The significant differences between Edison's and the staff's estimate of these items is ad valorem taxes. Edison's 1976 test year estimate of this item is $94,854,000 as compared to the staff's estimate of $89,577,000, a difference of $5,277,000. The record shows that Edison overestimated the 1975 assessed evaluation by $40,000,000 and the tax rate by ten cents per $100 of assessed value with the result that Edison's estimated 1975 taxes were approximately $2,200,000 higher than the recorded taxes. The staff's estimated 1975 taxes were only slightly higher than the recorded amount which tends to confirm the accuracy of the staff's 1976 ad valorem tax estimate and justifies its adoption. We will also adopt the staff's estimates, based on later data, of payroll and miscellaneous taxes.

Taxes—Income

There are two areas of differences between Edison's and the staff's 1976 income tax estimates, namely, (1) the staff's inclusion of an $11,000,000 tax deduction for repair allowance; and (2) the staff's adjustment to reflect the additional investment tax credit of $11,400,000 for 1976 allowed by the provisions of the Tax Reduction Act of 1975 (TRA).

In 1974 Edison filed an amended federal tax return for 1973 in which it claimed a $12,372,920 "Repair Allowance" as allowed under the A.D.R. regulations. This repair allowance is elective by each taxpayer each year based on whether or not he can avail himself of the right to take such an allowance. Each

type of plant, i.e., nuclear, hydraulic, steam, transmission, distribution, etc., has a specific repair allowance percentage that is permitted within certain limitations. Edison's repair allowance for the year 1973 reflected only transmission and distribution facilities. The allowance for such plant is two percent of the total qualifying plant. The requisite computations for the determination of the repair allowance can only be derived from an analysis of the previous year's completed word orders. Edison's witness testified that it is his belief that the above-mentioned $12,372,920 repair allowance for 1973 complies with the complex regulations governing such an allowance but that he won't know for sure until IRS audits the books. For this reason, Edison did not include a repair allowance in its estimates for the years 1974, 1975, and 1976.

The staff's engineer multiplied the 1973 repair allowance by the ratio of the average investment tax credit for the years 1973 through 1976 to the actual tax credit taken in 1973 to derive a computed repair allowance of $11,037,634 which he rounded to $11,000,000 for ratemaking purposes. This computation method is premised on the indirect relationship that both the ITC and repair allowance bear to current additions. This computed figure of $11,000,000 compares favorably to the actual repair allowance of $12,372,920 for 1973 and approximately $12,000,000 for 1974, appears reasonable, and will be adopted for the purposes of this proceeding.

TRA, signed into law by the President on March 29, 1975, provides, among other things, for an increase in the investment tax credit rate from four percent to 10 percent (seven percent for certain transmission

lines) for new qualified plant expenditures made subsequent to January 21, 1975 and before January 1, 1977, when the investment tax credit reverts back to the previous rate.

TRA further provides that those utilities, such as Edison, that use flow-through accounting for tax depreciation elect, by June 26, 1975, one of the following three options applicable to the authorized additional investment tax credit: Option 1—reduce rate base by the amount of the credit to be restored ratably over the book life of the affected properties, Option 2—credit income with the amortization of investment credit over the life of the property (ratable flow-through), or Option 3—flow-through immediately the additional credit to net revenue through reduced tax expense. On June 25, 1975, Edison elected Option 2—ratable flow-through.

TRA also provides that the additional ITC benefits shall not apply if the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of the allowable credit or if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the allowable credit.

In addition to the increased ITC allowances, TRA provided for the acceleration of credit allowances through the exercise of the Qualified Progress Expenditures (QPE) provision permitting the qualifying of a portion of each year's construction expenditures for investment credit. According to the rebuttal testimony of Edison's manager of taxes and assistant secretary, Mr. C. S. Reenders, the total ITC for the years 1975-1979 is as follows:

	1975 (1)	1976 (2)	1977 (3)	1978 (4)	1979 (5)	Total (6)
			(Thousands of Dollars)			
Flow Through 1971 Act @ 4%	$ 6.541	$ 7,377	$12,500	$ 8,600	$ 7,800	$ 42,818
Additional from QPE	1,259	5,823	11,200	14,600	21,600	54,482
Tot. Flow Through @ 4%	$ 7,800	$13,200	$23,700	$23,200	$29,400	$ 97,300
Deferred—Option 2 QPE and Qualified Plant Additions @ 6%	$ 4,320	$11,400	$ 7,200	$ 4,500	$ 4,200	$ 31,620
Total ITC	$12,120	$24,600	$30,900	$27,700	$33,600	$128,920

Associate Utilities Engineer, R. U. Joshi, testified that for ratemaking purposes he used direct flow-through for the original four percent investment tax credit, for four percent of the QPE, and for one-fifth of the additional six percent investment tax credit in that particular year. The remaining four-fifths of the additional credit was deducted from rate base. Such a procedure, according to this witness's testimony, would apportion the benefits of the additional ITC between the utility and the ratepayer. The benefits to the ratepayer would be the reduced revenue requirement associated with the tax credit and the benefit to the utility would be the additional cash available to it of $3,563,000 in 1975, $11,850,000 in 1976, $19,505,000 in 1977, $22,881,000 in 1978, $27,177,-000 in 1979, $16,727,000 in 1980, $8,573,000 in 1981, and $3,126,000 in 1982. The additional cash, according to the testimony, would result in a reduced revenue requirement of $891,000 in 1975, $4,077,000 in 1976, $9,973,000 in 1977, $18,187,000 in 1978, $29,529,000 in 1979, $35,525,000 in 1980, $32,206,-000 in 1981, $24,102,000 in 1982, and $15,640,000 in 1983. The staff witness further testified that for the five-year period 1975 through 1979 the additional investment tax credit generated would be $56,710,000 which under the staff's proposal, would result in $27,-177,000 of increased cash flow for Edison and a reduction of $29,533,000 in revenue requirement for the ratepayer.

Edison vehemently opposes the staff's ratemaking recommendations on the additional ITC provided by TRA on the following bases: (1) it combines a cost of service adjustment with a rate base adjustment either of which would, in Edison's opinion, deprive it of

its ability to obtain the additional ITC benefits provided for by TRA; (2) the impact of such a loss would be in excess of $15,000,000 for the year 1976 and, depending on the future action of Congress, for future years could be immense; (3) for the five-year period 1975-1979, the staff's proposal would flow through to the ratepayers 91.4 percent of the ITC benefits amounting to 97.8 percent of the revenue requirement reduction benefits as contrasted to Edison's proposal of flowing through 76.4 percent of the ITC benefits and 87.4 percent of the revenue requirement reduction; and (4) according to Edison the staff's recommendation violates the clear legislative purpose behind TRA of providing for a sharing of such benefits when Option 2 is elected by the utility by the application of ratable flow-through for ratemaking purposes. Mr. Reenders further testified that the selection of Option 2, ratable flow-through, was a prudent act because the effect of such an election is a reduction in external financing requirements and increased marketability of Edison's bonds due to the beneficial effects of normalization on times interest coverage which could result in the extension of the act and other further positive steps by the Federal Government in its efforts to improve the financial integrity of the electric utility industry. According to the testimony, such actions would assist Edison in the financing of new production facilities as intended by Congress. Similar arguments were advanced by Southern California Gas Company (SoCal) in connection with Application No. 55676 and Application No. 55544 for offset increases and by San Diego Gas & Electric Company (SDG&E) in connection with Application No. 55677 and Application No. 55543

for offset increases as justification for their election of Option 2.

In Decision No. 85627 dated March 30, 1976, in regard to SoCal, we reflected the decrease in investor risk associated with the increase in before taxes times interest coverage and the decrease in external financing requirements resulting from the election of Option 2 by a reduction of 0.25 percent in the authorized rate of return and, in regard to SDG&E, we accepted its election of Option 2 but served notice of again reviewing the issue in connection with its next general rate proceeding. Similarly, as previously noted, we included the decreased investor risk associated with Edison's election of Option 2 as a factor considered in arriving at our determination of a proper rate of return to authorize in this proceeding.

Depreciation Expense

For the test year 1976 the staff estimate for depreciation expense presented by Senior Utilities Engineer H. L. Ong is $123,328,000 exclusive of any wage adjustment whereas Edison's estimate for depreciation expense presented its valuation engineer, A. B. Bowker, for the same test year is $136,491,000, a difference of $13,163,000. Of this amount, $253,700 is attributable to a lower staff estimate of plant additions and $1,179,000 is due to the utilization of different lives for experimental transmission plant. The remaining $11,730,000 differential results from use by the staff of lower depreciation rates for transmission, distribution, and general plant accounts. The record shows that the staff's lower depreciation rates derive primarily from the staff's utilization of relatively higher future net salvage ratios which in turn results from the dif-

ferent treatment accorded "other items". As discussed on the record in this proceeding "other items" include monies paid Edison for the relocation of facilities and the settlement of damage claims, losses covered by Edison's self-insurance plans, the sales of utility plant such as in condemnation proceedings and reserve transfer and adjustment bookkeeping entries. In the past reimbursement received for such relocation and similar work was accounted for by (a) crediting operation and maintenance expenses to the extent of actual expenses occasioned by the plant changes and (b) crediting the remainder to contributions in aid of construction. The depreciation expense associated with this plant was used to reduce the balance of contributions in aid of construction. Under such an accounting procedure monies received as detailed above had no effect on the depreciation accrual amount. The staff engineer testified that, in his opinion, the accounting for reimbursements received from other parties should be done in accordance with NARUC Rule No. 67 which states in part:

> "The cost of plant retirement should be accounted for in accordance with the rule applicable thereto. The cost of new plant should be included in the appropriate plant accounts at actual cost of construction. The reimbursement received shall be accounted for (a) by crediting operation and maintenance expenses to the extent of actual expenses associated by the plant changes and (b) crediting the remainder to the reserve for depreciation, unless contractual terms definitely characterize residual or specific accounts as applicable to the cost of replacement. In the latter event, appropriate credit should be entered to the plant account."

Such a procedure would result in decreased depreciation accruals by either reducing the balance in plant accounts or increasing the balance in depreciation reserve. Another factor affecting "other items" was FPC Order No. 490 which eliminated Account 271, Contributions In Aid of Construction, effective January 1, 1974. As of that date the account balance for plant in service was ordered transferred to appropriate plant accounts and the residue of the account balance went to depreciation reserve. As a result of this order Edison adjusted its plant balances $86,710,657.23 and its depreciation reserve $13,170,935.73.

According to the staff engineer's testimony, the Commission staff's Standard Practice U-4, "Determination of Straight-Line Remaining Life Depreciation Accruals", states that future net salvage represents an estimate of the dollars which will be realized from the future retirement of all units now in service and that net salvage is gross salvage realized from resale, reuse, or scrap disposal of the retired units less cost of removal. In his opinion, "other items" fall within these parameters. This witness further testified that his estimates, although based on recorded data for the period 1969 through 1973, reflect a decrease in the percent of future net salvage from 18.73 to 17.46 percent. He contrasts these percentages with Edison's estimates indicating a decrease in future net salvage from 18.46 to 8.61 percent within a three-year period. He testified to his belief that such a radical change is completely unrealistic and unreasonable. Edison asserts that this rapid decline in the percentage of future net salvage to be realized indicates only that past practices have resulted in underaccruing for deprecia-

tion and not that its test year estimates are unreasonable.

Edison further argues that the money received as compensation for relocations is credited directly to expense and, thereby, results in a reduction in the recorded cost of operations. It is its viewpoint that to consider such monies in the nature of salvage in the development of depreciation expense is clearly a duplication of the reduction in cost of service.

We agree with the staff contention that monies received from governmental agencies for relocation work and similar projects are properly includable in deriving future net salvage in computing depreciation expense and accruals. However, in view of marked decline in freeway construction and other similar work that would normally produce monies for such relocation projects for inclusion as "other items", we will reduce the amount of monies to be received from such projects to one-half the amount included in the staff's estimates.

The staff witness also testified that Edison proposes to revise the average service lives for 15 plant accounts. With the exception of two accounts, Account 366, Underground Conduit, and Account 368, Line Transformers, Edison's proposed changes appear to the staff engineer to be reasonable. With respect to these two accounts Edison proposes to reduce the average service life for Account 366 plant from 75 to 45 and for Account 368 from 30 to 21 years. The staff used Edison's retirement data to develop average service lives for Account 366 by the Brennan, Bauhan, and Garland methods for spans of five, 10, and 15 years. The average service lives thus developed ranged from 35 to 74 years indicating to the staff engineer that

a reduction of service lives for this account was warranted but that 55 years would be more appropriate than the 45 year life proposed by Edison. Similar studies made for Account 368 plant indicated a spread of average service lives ranging from 19 to 27 years resulting in the staff engineer's recommendation of an average service life of 24 years as compared to Edison's proposed use of 21 years. We will adopt an approximate midpoint of the spread of service life indicated by the three studies for these two accounts resulting in the utilization of a service life of 55 years for Account 366 and 23 years for Account 368.

Our adopted test year depreciation expense will therefore be $131,171,000 reflecting the staff's estimated depreciation expense increased by $7,400,000 to reflect less relocation work and $443,000 to reflect a decrease in the average service life of Account 368 plant from 24 to 23 years.

C—RATE BASE

General

For the test year 1976 the Commission staff's estimate of rate base presented by Mr. Ong exclusive of wage adjustment was $3,838,830,000 as compared to Edison's estimate presented by its senior plant appraiser, Mr. L. O. Chubb, of $4,338,300,000, a difference of $499,470,000 or 13.1 percent. As shown in the following tabulation the primary differences in estimates in order of diminishing magnitude are: (a) the staff's disallowance of any nonoperative construction work in progress, (b) the staff's use of weighted average rather than year-end balances of replacement plant and/or plant installed to meet environmental requirements when such plant will not contribute to increased

production or revenues, (c) the staff's recommended reduction in fossil fuel stock in the working capital allowance, and (d) the staff's assumed reduction of additions in distribution transformer plant as a result of the continuation of Edison's transformer load management program.

Item	Staff	Edison	Adopted[1]
	(000)	(000)	(000)
Utility Plant			
Beg. of Yr. Plt. in Service	$4,433,281	$4,438,000	$4,433,281
Nuclear fuel, Oper. CWIP	111,000	111,000	111,000
Prop. Held Future Use	59,502	61,000	61,000
Nonoperative CWIP	—	310,000	—
Total Beg. of Yr.	$4,603,783	$4,920,000	$4,605,281
Weighted Average Additions			
Plant in Service[2]	$ 57,169	$ 61,200	$ 59,169
Nuc. Fuel & Oper. CWIP	9,400	9,400	9,400
Prop. Held Future Use	1,325	1,900	1,900
Nonoperative CWIP	—	90,000	—
Special Items—Nonweighted	—	66,000	—
Total Wt. Avg. Adds	$ 67,894	$ 228,500	$ 70,469
Adjustments (Cust. Advances)	$ (19,273)	$ (19,000)	$ (19,273)
Working Capital			
Fuel Stock—Fossil	$ 209,105	$ 256,200	$ 192,187
M&S and Fuel Prepayment	29,400	29,400	29,400
Working Cash Allowance	179,864	164,000	161,292
Total Working Capital	$ 418,369	$ 449,600	$ 382,879
Total Before Deductions of Reserve	$5,070,773	$5,579,100	$5,039,356
Deductions for Reserve	$1,231,943	$1,240,800	$1,237,220
Rate Base	$3,838,830	$4,338,300	$3,802,136

[1]Basis for adopted figures set forth in ensuing paragraphs.

[2]Includes additions of distribution line transformers.

Nonoperative CWIP in Rate Base

The inclusion or exclusion of nonoperative construction work in progress (NOCWIP), involves a question of fundamental regulatory policy. Historically, utilities subject to this Commission's jurisdiction have accrued an allowance for funds used during construction (ADC) on CWIP. This was done to capitalize the carrying charges or financing cost during the period when the plant is under construction. The ADC so applied is capitalized as part of the total construction cost when the plant becomes operative.

Such CWIP included in the ADC base has thus been excluded from rate base on the theory that ratepayers should pay a return only on revenue produced by plant that is used and useful for utility services supplied. Edison proposes to include NOCWIP in rate base as a means of improving its cash flow to reduce its external capital requirements needed to finance its ongoing construction programs. Edison contends that with a plant expenditure program projected at almost three billion dollars for the five-year period 1974 through 1978 (excluding refunding requirements) of which capital from external resources exceeds 2.1 billion dollars any procedure which will reduce the need for additional outside capital will aid materially in meeting such financing requirements. Mr. Smith Davis testified that the inclusion of NOCWIP in rate base at rates of return in the nine to 10 percent range would reduce its reliance on outside sources of capital by approximately $138,000,000 by the third year or 10 percent of its capital requirements and result in a reduction of dividend requirements of over $9,000,000.

In the past when both construction time and cost of capital were relatively much less than at present

the inclusion or exclusion of NOCWIP in rate base a very minor effect on a utility's financing. In this matter, however, with the $400,000,000 NOCWIP that Edison requests be included in rate base representing in excess of ten percent of the staff's estimated test year rate base, with the current allowance for interest during construction rate at the eight percent level, and with the cost of capital approaching the nine percent level, we will review our position on this issue.

Testimony and exhibits on the inclusion of NOCWIP in rate base were presented on behalf of the Commission staff by Mr. Ong and by Financial Examiner J. A. Bilci and on behalf of Edison by Mr. Smith Davis and Mr. L. Chubb. The staff's financial examiner urged the Commission to consider that the inclusion of NOCWIP in rate base will result in a minimal improvement in cash flow, will have the effect of shifting revenue requirements from future customers to present day customers, and could eliminate or reduce Edison's incentive to expedite the completion of construction projects since uncompleted projects were included in the same rate of return computations as completed plant in service. He noted, however, that over the life of the plant the inclusion of NOCWIP in rate base results in a smaller total revenue requirement for the ratepayer than if an allowance for funds used during this construction is added to the dollar amounts of CWIP and the total is included in future rate base computations. He further recommended that if we permit NOCWIP in rate base that Edison be allowed to include only $300,000,000 of NOCWIP in rate base rather than the requested $400,000,000 amount and, also, that Edison be ordered to prepare a study to show the impact on other methods of improving cash flow and bond interest coverage that are available to it. He further testified that inadequate cash flow is a serious problem facing many utilities but that absent any showing that the inclusion of NOCWIP in rate base is the best alternative available to Edison to increase its cash flow he is in no position to make a positive recommendation urging that Edison's request be granted. The staff witness also mentioned the fact that every dollar of cash flow resulting from the allowance of NOCWIP in rate base requires two dollars of revenue be supplied by the ratepayer which, in his opinion, has a dampening effect on the initial appeal of such action.

In our recent decision concerning PG&E (Decision No. 86281 dated August 24, 1976 in Application No. 55509), we reviewed in detail our position on CWIP and came to the conclusion that CWIP should not be included in rate base. We are not persuaded that Edison's financial position is so different from PG&E's that we should arrive at a different result.

We are acutely aware of the benefits and burdens created by including CWIP in rate base, and in the PG&E decision we suggested possible alternatives, especially one that would expedite the inclusion in rate base of plant as it comes on line. But our conclusion in PG&E is equally applicable here, where we said:

> "We recognize that with the unprecedented demands for new capital presently confronting utilities that they are obliged to seek new and different methods of financing, including customer participation in raising funds for plant construction. At the same time, we have a continuing concern that because of the impact of income

taxes that proposals such as inclusion of CWIP in rate base require more than $2 of added revenues from customers for each dollar of additional cash flow finally made available to the utility. We urge applicant to carefully explore all methods of customer participation in meeting financial needs that will eliminate this 'two-to-one' tax effect." (Decision No. 86281, page 52.)

It has been brought to our attention that as part of the overall treatment of CWIP is the subsidiary issue of "phantom" taxes. This issue arises from the tax treatment of ITC and bond interest relating to CWIP and interest during construction. In Edison's next rate case we will expect Edison and the staff to present evidence and exhibits showing the tax treatment resulting from various methods of considering CWIP and interest during construction.

Special Items—Nonweighted

Edison proposes to depart further from historical rate base considerations by the inclusion in rate base of the year-end, rather than weighted average, balance of $66,000,000 of certain nonrevenue increasing items such as replacement plan and plant installed to meet environmental requirements. For the test year 1976, Edison proposes to discontinue the inclusion of these special items in the ADC base and include them in rate base at their year-end balance rather than on the basis of completed weighted average additions. These replacement items, consisting generally of deteriorated distribution plant, storm damaged items, and overhead-to-underground conversion projects, appear to have relatively short construction periods and, therefore, no departure from past practices appears justified. Also

lacking in this record is convincing evidence that justifies special treatment of environmental items as contrasted with other NOCWIP. Consequently, the special items will be included in the ADC base until completed and placed in service when they will be included in rate base on a weighted average basis as has been done historically.

Fossil Fuel Stock Estimate

Fossil fuel stock is comprised of fuel oil and coal in inventory for the operation of fossil fuel generating plants. To safeguard against the impact of possible involuntary energy curtailment, Edison maintains sufficient quantities of fuel stock to operate for approximately 90 days. The month-end inventory of fuel oil is derived by deducting the current month's burn from the previous month-end inventory on a first-in-first-out (FIFO) basis, and then adding in quantities received during the month at the current market price. In computing its inventory balances, Edison utilized the recorded average balances of fuel oil stock. It is the staff's position that such balances reflect more than a normal supply due to the 1974 above average availability of hydrogenerated energy which reduced the amount of oil burned to below average year quantities.

In Decision No. 84577 dated June 24, 1975 in Application No. 55198, we found that the fuel oil inventory of 14,600,000 barrels estimated for year-end 1975 represented approximately the 90-day supply required to protect Edison against an interruption in supply. We will adopt the 14,600,000 barrels as the amount of fuel oil to be included as fossil fuel stock which at $15.868 per barrel utilized by the staff en-

gineer in the preparation of his estimate results in a rate base allowance of $231,673,000 excluding an adjustment for unpaid invoices. The staff used the average percentage of unpaid invoices of 25.87 percent for the years 1971 through 1974, whereas Edison's unpaid invoice adjustment figure was 20 percent based on the weighted average dollar amount for the period 1971 through 1974. In view of the abnormally low dollar value of purchases made during the year 1974 because of the availability of greater than average energy supplies from the Pacific Northwest, the utilization of weighted dollar figures including such an abnormal year would tend to distort the results. Consequently, we will adopt the staff's unpaid invoice balance rounded to 25 percent. Under these circumstances, the fossil fuel stock allowance which we will adopt for ratemaking purposes is $192,187,000 consisting of 75 percent of the adopted fuel oil inventory amount and $19,433,000 for other fossil fuel.

Transformer Load Management

The staff witness noted that Edison increased its Account 583, Overhead Line Expense, $1,090,000 in 1975 and $1,450,000 in 1976 for the escalation of its transformer load management program (TLM). He reflected these increased TLM expenses by a reduction of Edison's budgeted distribution transformer plant additions of $4,719,000 for the year 1975 and $8,333,000 for the test year 1976. The $8,333,000 figure was based on information supplied by Edison that TLM had resulted in a reduction in distribution plant below that which would have been required absent TLM of $50,000,000 in a six-year period. It is Edison's position that the reduction of $50,000,000 in rate base

results in annual savings in return and depreciation expense in excess of $9,000,000, and justifies continuation of the program. Edison argues that there is no basis for assuming a continuation of the $8,333,000 reduction in transformer plant additions. The record shows that Edison estimates that the reduction in transformer additions for the test year 1976 would be $3,200,000 or $1,600,000 on a weighted average basis. Edison's contention that the initial annual reduction in plant additions of $8,333,000 will not be sustained appears logical but an approximate two-thirds reduction in the savings in plant additions appears excessive. We will therefore adopt the staff's estimate of $4,-433,281,000 beginning-of-year plant in service and $59,169,000 weighted average additions to plant in service to reflect a reduction in transformer plant additions of approximately $4,000,000 over the budgeted amount as a result of TLM.

Ormond Beach Plant Cost

The Ormond Beach generating station was charged with the cost of a contract to construct an off-shore marine oil pipeline mooring facility. Edison consummated this contract without receiving prior approval from responsible governmental agencies. The approval was denied and the project was terminated in 1973 at a cost to Edison of approximately $670,000. This amount was retained in the work order costs for the utility plant. The staff's financial examiner recommends that the item be removed from the utility plant accounts

and that Edison strengthen its procedure for receiving permit approval before undertaking similar projects in the future. It is axiomatic that some design and engineering costs have to be incurred prior to receipt of governmental approval on a contemplated project in order to have sufficient information upon which to base a request for such governmental approval. Under these circumstances, we will permit the disputed plant costs to remain in rate base.

D—SUMMARY OF EARNINGS

In 1964 the United States Supreme Court held that the sale of electric energy to the city of Colton was a sale at wholesale in interstate commerce within the meaning of the Federal Power Act. (*Southern California Edison Company and California Public Utilities Commission v Federal Power Commission and city of Colton* (1964) 376 US 205, 11 L ed 2d 638.) As a result of that decision, it is necessary in proceedings, as in this one, where resale service is present to segregate revenues and allocate expense and rate base items between those subject to our jurisdiction and those subject to the jurisdiction of other regulatory agencies. The following tabulation summarizes the previously discussed adopted results of operations and, utilizing the subsequently discussed monthly peak responsibility method, the apportionment of revenues and allocation of expense and rate base items between those subject to our jurisdiction and those that are not.

SUMMARY OF EARNINGS
Year 1976 at Present Rates

Item	System	CPUC
	(Dollars in Thousands)	
Operating Revenues		
Revenues[1]	$1,232,883	$1,166,807
Operating Expenses		
Production[2]	480,061	442,685
Transmission	37,299	34,635
Distribution	64,677	64,584
Customer Accounts	30,901	30,890
Sales	1,984	1,984
Conservation Program Expense	2,400	2,400
Administration & General	85,584	82,832
Subtotal	702,906	660,010
Special Amortization[3]	547	529
Net Wage Adjustment	(8,948)	(8,656)
Depreciation	131,171	126,294
Taxes Other Than Income	100,169	95,936
Income Taxes	32,054	30,652
Total Operating Expense	957,899	904,765
Net Operating Revenue	274,984	262,042
Rate Base	3,802,136	3,629,462
Rate of Return	7.23%	7.22%

(Red Figure)

[1]At base rates established by Decision No. 81919.

[2]At unit costs and fuel mix adopted in Decision No. 81919.

[3]Huntington Beach write-off.

V—COST ALLOCATION

General

This Commission, together with numerous other utility regulatory agencies and practitioners, has consistently held that cost-of-service is an important guideline in the reasonable apportionment of overall revenue increases among the various customer groups. For any given operation, the method of classifying expense and

rate base items into components and allocating these components to the various groups can materially affect the groups' indicated costs of service. Under these circumstances, it is not surprising that representatives of a particular customer group would advocate classification and allocation methods that cast their group in the most advantageous light. Evidentiary cost allocation material was presented in this proceeding by Edison, the Commission staff, TURN, Kaiser, CMA, Committee, and Government.

As previously stated, it was first necessary to segregate revenues and allocate expense and rate base items between those subject to our jurisdiction and those subject to the jurisdiction of other regulatory agencies. CPUC jurisdictional expense and rate base items were then allocated to the following customer groups: Domestic (Schedules D-1/6, DWL, and portion of OL-1); Lighting and Small Power (Schedules A-1/6, P-1, TC-1, and a portion of OL-1: Large Power (Schedule A-7 and Sequoia Park); Very Large Power (Schedule A-8 and Edwards A.F.B.); Agricultural Power (Schedules PA-1 and 2); Street Lighting (Schedules LS-1 and 2); and Off-peak (MWD).

After the overall costs to serve have been established by an appropriate results of operation study, the first steps in the process of arrangement of cost groups for purposes of allocation are functionalization and classification. In this proceeding expenses and rate base items, exclusive of Santa Catalina Island, Pacific Intertie, Other Electric Revenue, Fringe, and Pooling contracts, are functionalized into Power Pool and Distributing System and classified into demand, commodity, and customer components.

Consistent with its showing in its recent rate increase applications, Edison classified as commodity the following: 100 percent of its production fuel expense; that portion of purchased power expense computed by the energy charge; certain items from production-other expense; 50 percent of all hydro expenses (including O&M, A&G, depreciation, taxes, and return); percentages of production maintenance costs, and fossil fuel handling costs. Classified as demand component are the remainder of production-other expenses and purchased power expense, production rate base, and all transmission expenses and rate base. Distributing system expenses and rate base items were classified between commodity, demand, and customer components by analysis. The Commission staff's witnesses, Supervising Utilities Engineer D. L. Houck and Senior Utilities Engineer P. E. Golsan, Jr., used the same classification procedure as Edison.

Statements of the alleged inappropriateness of some of the above classifications were included in the testimony of some of the various witnesses. G. B. Scheer, testifying on behalf of Kaiser Steel Corporation (Kaiser), and D. J. Reed, testifying on behalf of Government, both took issue with Edison's and staff's classification of 100 percent of fuel and fuel handling expense as commodity stating that, in their opinion, no-load fuel and fuel handling costs should be included in the demand component. In support of his position on no-load fuel, Mr. Reed quoted excerpts from the NARUC Cost Allocation Manual indicating that fuel is the best example of an energy-related cost, at least, beyond the level of no-load fuel and that some argue that no-load fuel should be classified as demand component. He also noted that both the staff and

the utility treated no-load fuel as a demand cost in cost allocation studies prepared in connection with PG&E's Application No. 54279. Edison's assistant manager of the Systems Operation Division of the Power Supply Department, M. H. Kent, testified that Edison does not operate its generating units at no-load, but provides spinning reserve from a number of partially loaded units. Such operations justify the exclusion of no-load fuel (assuming that a reasonable figure could be derived) from the demand component. We will, therefore, accept the staff's and Edison's classification of fuel as 100 percent commodity.

Mr. Reed further quoted from the NARUC Cost Allocation Manual to support the classification of fuel handling expense as being demand related as follows:

> "Some utilities have considerable plant investment in fuel handling equipment, such as piping for natural gas, oil, or slurry, and nuclear fuel handling equipment. If the fuel were delivered to the plant, rather than through the utilities' equipment, the cost of the fuel would reflect any costs associated with delivering the fuel to the plant. Therefore, it is sometimes argued that the plant-related costs of the fuel-handling equipment should be classified as an energy-related cost. *It should be evident, however, that such investment, while unaffected by variations in energy use, is directly related to the capacity requirements of the utility.*" (Emphasis added by witness.)

Such a statement supports the witness' position that fuel handling costs should be classified for inclusion in the demand component. However, FPC Order No. 421 (Docket No. R-391) added Item 4 for inclusion

in Account No. 151, Fuel Stock, on the basis that these costs should be included in the fuel stock account so that the cost of fuel would be more accurately reflected. Item 4 reads:

> "Operating, maintenance and depreciation expenses and ad valorem taxes on utility-owned transportation equipment used to transport fuel from the point of acquisition to the unloading point."

With the FPC requirement that fuel handling cost be included as a cost in the fuel stock account the staff's and Edison's inclusion of these costs in the commodity component is appropriate.

Edison's chief regulatory cost engineer, E. R. Sample, was cross-examined in detail on the basis for the classification of 50 percent of hydro expenses as being energy-related for inclusion in the commodity component. He responded that only the energy available during an adverse hydro year could be considered as dependable capacity and, therefore, only those rate base and expense items related to this dependable capacity, expressed as a percentage of total hydro rate base and expense items, are properly included in the demand component. On the Edison system, according to this witness' testimony, adverse hydro year generation is approximately one-half that of an average hydro year generation forming the basis for the 50 percent figure. This methodology is discussed as an acceptable basis for classification of hydro rate base and expense items in the NARUC manual. In view of Edison's past practices and the general acceptability of this method, its adoption in this proceeding is warranted.

The record indicates that most of the rate base and expense items relating to the distributing system

are classified by Edison as includable in the customer component. In sharp contrast to this practice, Dr. Coyle of TURN would include in the customer component only costs relating to meters, services, and customer accounting and collecting and Dr. Dunn of Committee would include only the costs of metering, billing, customer accounting, service to customers, uncollectibles, and the ownership and maintenance cost of that portion of the distribution system actually used to serve a given class. The other distributing system items would be classified by both of these witnesses as demand related. Such positions are generally supported by the NARUC manual which specifies either the minimum size of facilities or the zero intercept methods of classifying distribution facility items between demand and customer components. Mr. Sample, in his rebuttal testimony supporting Edison's method of classification of distribution facility items to customer groups, stated that the allocations are based on the weighted number of customers and the use of weighting factors which reflect size and usage, and produce results that are not dissimilar to those obtained by the use of methods advocated by others. Edison's position does not appear unreasonable and we will not further pursue the matter at this time. We will, however, place Edison on notice that the similarity of results produced by Edison's method and either of the two methods discussed in the NARUC manual will have to be satisfactorily verified before we will accept such results in future proceedings.

Allocation of Demand-Related Costs

The allocation of the commodity component to groups on the basis of kilowatt-hour sales at a common level and the allocation of the customer component

to groups on the basis of average or weighted number of customers is relatively straightforward and noncontroversial. The basis for the allocation of the demand component, however, can be, and often is, highly controversial. The three methods discussed in detail on the record in this proceeding were the Load Factor-Diversity Factor (LFDF), the Maximum Non-Coincident Demand (NCD), and the Monthly Peak Responsibility (MPR) methods. The record shows that Edison has used the LFDF method for the allocation of the demand component to customer groups since 1952 and the MPR method for the allocation of this component to jurisdictions since 1970. In both Decision No. 78802 dated June 15, 1971 in Application No. 52336 and Decision No. 81919 we found these methods of allocating rate base and expense items between jurisdictions and California jurisdictional customer groups reasonable.

In general the results derived from the application of the NCD method produce results that favor the relatively high load factor groups whereas the MPR results favor the relatively low load factor groups. It is, therefore, not surprising that Mr. Reed, testifying on behalf of Government, advocated the use of the NCD method of allocating demand-related items, whereas Dr. Coyle, testifying on behalf of TURN, urged the use of the MPR method for such allocations. Both of these witnesses, although presenting widely divergent viewpoints, took issue with both the theoretical validity and the practical application of the LFDF method.

Mr. Reed testified that the LFDF method is a cost reclassification rather than a cost allocation method. He stated that once the costs have been classified as between demand-related costs and commodity-related

costs the application of LFDF formulae to the demand-related costs results, in the case of Edison, in approximately 20 percent of the demand-related costs being reclassified as commodity-related costs. Mr. Reed's prepared testimony (Exhibit 100) contained quotes from articles by such well-known utility regulatory theorists as C. S. Reed, H. W. Hill, and Constantine Bary supporting the following conclusions on the LFDF method of allocating demand-related rate base and expense items: (1) the LFDF method encourages low monthly and low annual load factors because it rewards the type of customer whose load characteristic is minimal to the best interests of the utility; (2) within the actual range of load factors utilized for cost-of-service studies, the contribution of a customer group to the system peak demand is independent of the customer group's annual load factor invalidating the theoretical conclusion that the LFDF method allocates diversity benefits in proportion to each customer group's contribution to such benefits; and (3) diversity and coincident factors of customer groups are materially influenced by the variance of weather conditions from normal weather conditions. The LFDF method of allocating demand-related items differs from the NCD method in the apportionment of diversity benefits. This differential is reflected in the apportionment of a percentage of the demand-related costs on the basis of average demands and the remainder on the basis of maximum non-coincident demands. The mathematical result of this procedure is the same as though a portion of the demand-related items were to be reclassified as commodity. There is, however, a theoretical differential which cannot be overlooked and that is that the apportionment of costs on average demand is a demand

and not a commodity apportionment. It is noted that although Mr. Reed quotes widely from various portions of the NARUC manual there are no quotes from Chapter VII "Summary of Results and Conclusions". Of particular interest in this discussion is the following quote relating to the Load Factor-Excess Demand (LFED) method which yields the same customer group total allocated costs as the LFDF:

> "The Load Factor-Excess Demand method is based on the premise that a linear relationship exists between a customer group demand coincidence and load factor. The application of this method allocates proportionately less of the diversity benefits to the high load factor customer groups and more to the low load factor groups. The Load Factor-Excess Demand method is recommended as a suitable vehicle to properly allocate costs where a number of significant peak loads increase the probability of greater participation by the high load factor customers."

Mr. Houck advocated the use of the MPR method for the allocation of California jurisdictional power pool costs and the LFDF method for the allocation of distributing system costs. Dr. Coyle in his prepared testimony (Exhibit 98) stated that the NCD method, applicable to approximately 80 percent of the demand-related items on the Edison system, is not appropriate for allocating demand costs on the basis that it gives no consideration to the time of customer group peak demand as related to system peak demands. He agrees with the staff that MPR should be used for the California jurisdictional allocations as well as for the allocations between jurisdictions.

In its brief, Edison argues that the MPR method has two serious defects that preclude its suitability for use for California jurisdictional allocations in this proceeding: (1) lack of data indicating what the simultaneous peak of the customer groups is at the time of system peak; and (2) the wide variation of results that could obtain as a result of the shifting of time of system peak. It is obvious from the record that there is some validity to both of these purported defects. The lack of suitable data is highlighted by the staff's presentation (Exhibit 95) wherein the MPR results are shown for a composite customer group consisting of Lighting and Small Power, Agricultural and Pumping, Street Lighting, and Off-Peak because of the unavailability of data for the individual customer groups. In addition, as argued in Government's briefs, the accuracy of the allocations based on 1973 test data, the year in which OPEC embargoed oil with the result that this Commission instituted conservation regulations, coupled with the experienced mild winter, is highly questionable. In spite of these infirmities, however, the results presented in the staff's study serve a useful purpose in emphasizing the spread of results obtainable by the use of the various widely accepted alternate methods available for classification and allocation of demand-related costs.

After a careful review of the exhaustive and detailed cost allocation data contained in the record of this proceeding, we are persuaded that the MPR method for jurisdictional allocations is reasonable and should be extended for California jurisdictional operations in the manner recommended by our staff.

We are putting Edison on notice, however, that it should expand its load study program to enable

an MPR allocation of demand costs between all customer groups to be made in any future rate proceeding before this Commission. Edison is well aware of the Commission's orders concerning time-of-day rates for electric service. Customer groups which benefit the system by shifting loads off the system peak due to the implementation of time-of-day rates, load management programs, or conservation efforts, would receive a commensurate reduction in assisgned costs under a peak responsibility method of allocating such costs. Because of this compatibility of peak responsibility allocation with load shifting practices being promoted by this Commission, we expect Edison to submit alternate allocation studies for production and transmission demand related costs in any future rate proceeding it may file before this Commission.

VI—RATE DESIGN

General

The apportionment of any authorized increase to the various customer groups and the appropriate design for the various rates within the respective groups were by far the most controverted issues raised in this proceeding. Most of the testimony and exhibits presented by other than the Commission staff and Edison related to this subject. In order of their appearance, presentations were made by Norman E. Nichols and Dennis B. Whitney, on behalf of the Los Angeles Department of Water and Power; George B. Scheer, on behalf of Kaiser Steel Corporation; D. J. Reed, on behalf of the U.S. Department of Defense; Lloyd H. Harvego, on behalf of California Department of Water Resources; Emerson Lewis, Richard B. Pool, and Silas L. Yount, on behalf of California Manufacturers Association; Dr.

Eugene P. Coyle, on behalf of TURN; Dr. C. L. Dunn, on behalf of Committee; D. J. Reed, on behalf of California Manufacturers Association; W. J. Govan, on behalf of Committee; John F. Roberts, Jr., and Norman Busch, on behalf of Western Mobilehome Association; and Dennis Kavanagh, on behalf of Golden State Mobilehome Owners League.

However, only Edison and the Commission staff proposed a complete set of rates. Edison's proposed rates, presented by its manager of rates, John L. Dee, purportedly reflect consideration of many factors including rate history, revenue stability, characteristics of use, zoning criteria, comparison with other utilities, cost-of-service, environmental factors, value of service, and comparative considerations, together with reliance on judgment and experience in applying such factors to reach a conclusion as to proper rate design. In general, the changes in rate design from prior rates contained in Edison's proposals reflect a leveling of the rates from the initial block to the terminal block, substantial increases in the customer charge in the domestic and general service rates, and substantial increases in the demand charges of the large power and very large power rates.

The staff's recommended rates presented by Mr. Houck were designed to yield 50 percent and 100 percent of the requested revenue increase with the intent that the relative apportionment of any authorized increase could be interpolated for intermediate values. The staff first designed domestic rate alternatives consistent with its interpretation of our lifeline rate policy enunciated in Decision No. 84902. At the 100 percent of requested increase level, this amounted to approximately $51 million. According to the testimony, the

remaining $287 million of the requested increase was apportioned to the remaining customer groups after considering various factors such as the relative variation in rates of return between large power and very large power customers and their relationship to the other customer groups and the total company return and the relative percentage increases that would result for the various customer groups.

Related Matters

At the time of issuance of Decision No. 85294 granting Edison a partial general rate increase we had before us three matters affecting the overall rate design issue on this matter as follows: Case No. 9804, our investigation into changes, if any, to be made to electric rate structures to encourage conservation of electricity; Case No. 9886, our investigation into electric utility fuel cost adjustment tariff provisions and procedures; and Case No. 9988, our investigation into the determination of a lifeline volume of gas and a lifeline quantity of electricity and into gas and electric utility rate structures and the changes, if any, that should be made in presently constituted rate structures to provide a lifeline quantity of energy to the average residential user for specified end uses. Decision No. 85559 dated March 16, 1976, Decision No. 85731 dated April 27, 1976, and Decision No. 86087 dated July 13, 1976 were rendered on these matters. Many of the active participants in this proceeding were also active participants in one or more of the above proceedings with the result that parallel presentations were sometimes made in two or more of these proceedings.

Case No. 9804 was undertaken pursuant to the request of Legislature in Assembly Concurrent Resolu-

tion No. 192 urging a thorough investigation of alternate rate structures designed to discourage rather than encourage increased consumption of electricity. The alternatives specified for inclusion in the investigation were discount prices for reduced consumption, placing all increases in tailblocks, inversion of rate structure, time of day pricing, seasonal peak pricing, and marginal cost pricing. In addition, we expanded our investigation to include rates based on price elasticity, special rates for large domestic users, rates for small domestic users, rates related to peak loads, and other relevant alternatives. Decision No. 85559 requires the major electric respondents, including Edison, to file time-of-day pricing tariffs for large usage customers having the requisite metering equipment, to install additional metering for customers whose demand exceeds 500 KW and file time-of-day tariffs for such customers, submit proposals for time-of-day pricing tariffs for customers whose demands are less than 500 KW, submit proposals for experimentation with end-use tariffs such as for air conditioning, study and submit annual proposals on price elasticity and cross-elasticity, file experimental tariffs for the application of peak load pricing to large domestic users who install load-shedding or similar devices, cooperate with large customers in the development of load management techniques, and submit specific proposals for the utilization of waste heat developed by certain industrial customers. Decision No. 85559 also found that marginal cost data would be useful in establishing rates, and that both average and marginal cost data should be used by this Commission in designing rates for electric service. Edison is hereby put on notice that marginal cost data must be included with any future rate application filing before this Commission.

As previously discussed, Decision No. 85731 provided the basis for the establishment of an energy cost adjustment clause to replace the presently effective fuel cost adjustment billing factor.

Decision No. 86087 established lifeline quantities of electricity for basic residential use, water heating, and space heating for four climatic zones for single-family and multi-unit complexes. The revenue effect of the establishment of these lifeline quantities of electricity was included in our consideration of the appropriate apportionment of the authorized revenue increase to the various customer groups.

Rate Spread

A reveiw of the copious material presented by parties to this proceeding on the allocation of the authorized rate increase leads us to the conclusion that a uniform cents-per-kilowatt-hour increase is the most appropriate method to utilize in this matter. This decision takes into consideration the fact that the overall increase being authorized herein is substantially less than the amount requested by Edison, and further that a rate reduction of similar magnitude on a uniform cents-per-kilowatt-hour basis due to an energy cost adjustment clause filing is being issued concurrently with this decision. We will maintain the domestic schedule restructuring and uniform cents-per-kilowatt-hour increase to all other schedules from the interim decision and will also apportion the additional increase of $44.5 million to the California jurisdictional customer groups including lifeline sales on the basis of a uniform cents-per-kilowatt-hour increase. Because of a concurrent reduction in Edison's ECABF, the utility's revenue level will not be increased as a result of the ECAC decision being issued simultaneously with this general rate in-

crease decision. However, with the corresponding reduction in the ECAC rate, the bills for lifeline usage will result in lifeline rates being maintained at the January 1, 1976 level. A summary of the adopted increases by customer groups is as follows:

Customer Group	Sales M²Kwh	Pre-interim Revenues	ECAC Revenues	Total Pre-interim Revenues
		(Dollars in Thousands)		
Domestic	14,000	$ 449,962	$132,860	$ 582,822
Lighting & Small Power	9,626	278,948	91,351	370,299
Large Power	12,911	227,651	122,525	350,176
Very Large Power	9,103	119,733	86,387	206,120
Agricultural & Pumping	2,150	48,352	20,404	68,756
Street Lighting	621	29,651	5,893	35,454
Total Customer Group	48,411	1,154,207	459,420	1,613,627
Other	1,100	12,600	—	12,600
Total Jurisdictional	49,511	$1,166,807	$459,420	$1,626,227

Customer Group	Interim Increase	Current Revenue	Adopted Increase Amount	Adopted Increase Percent[1]
		(Dollars in Thousands)		
Domestic	$ 9,740	$ 592,562	$12,870	2.17%
Lighting & Small Power	19,240	389,539	8,850	2.27
Large Power	25,530	375,706	11,870	3.16
Very Large Power	18,050	224,170	8,370	3.73
Agricultural & Pumping	4,300	73,056	1,970	2.70
Street Lighting	1,240	36,694	570	1.55
Total Customer Group	78,100	1,691,727	44,500	2.63
Other	—	12,600	—	—
Total Jurisdictional	$78,100	$1,704,327	$44,500	2.61

[1]Above current revenue.

DWR Contracts

Testimony and exhibits were presented by Edison, the Los Angeles Department of Water and Power (LADWP), and the California Division of Water Resources (DWR) relative to the following agreements:

the supplier's contract between PG&E, SDG&E, Edison, LADWP, the State of California, and DWR; the purchase contract between PG&E, SDG&E, Edison, and DWR; and the EHV contract between Edison, PG&E, SDG&E, and DWR.

The supplier's contract provides for supplying capacity and energy to DWR for the operation of its pumping plants on the aqueduct system of the State Water Project at 3.0 mills per kilowatt-hour and 20,000 kilowatts of on-peak capacity at $17 per kilowatt-year. The purchase agreement provides for the purchase of the output of DWR's Hyatt (Oroville)-Thermalito hydroelectric power plants at approximately 2.59 mills per kilowatt-hour for energy and $12 per kilowatt-year for capacity. The EHV contract provides, among other things, for the sale to Edison of substantial portions of the DWR entitlement to Canadian entitlement power at 2.6 mills per kilowatt-hour for energy and $6.60 per kilowatt-year for capacity.

It is Edison's position that the revenue received under the supplier's contract is not adequate to cover the cost of generating such energy and that the purchase cost of energy bought under the purchase and EHV contracts is well below current and future costs of providing such power under alternative arrangements. Edison argues that under such present arrangements it is the shareholders who bear the burden of the revenue deficiency and the ratepayers derive the benefit of the cost-of-service reduction. Edison proposes that the benefits and burdens be equalized by either (1) reflecting only the actual revenues received when computing revenue requirements; or (2) by imposing a fuel cost adjustment on sales to DWR. Alternative (1) is recommended by Edison because of the possibil-

ity of DWR withdrawing the Oroville-Thermalito power for its own use with a resultant need by Edison of obtaining substitute power.

LADWP favors alternative (2) on the basis that a fuel cost adjustment would cause the price paid for energy by DWR to more closely reflect the actual cost of such energy and DWR favors alternative (1) on the basis that all three contracts should be considered as a whole with both the benefits and burdens accruing to the ratepayer.

According to testimony of Edison's witness, alternative (1) could be implemented by the simple expedient of proper application of the cost allocation procedure. Equating the purchased power expense to the revenues received from the sales, however, only accommodates a portion of the alleged revenue deficiency burden being applied to the stockholder. The major portion of the revenue deficiency burden would have to be shifted from the shareholder to the ratepayer by a slight modification of the method of computing the fuel cost adjustment billing factor. Decision No. 85731 provides that the revenue deficiency for sales to DWR be included in the ECAC revenues to be recovered from the balance of the ratepayers, thereby adopting, in effect, alternative (1). Consequently, no further consideration of this item is necessary in this proceeding.

VII—SERVICE

During the first eight days of hearing several parties presented statements or testimony concerning alleged service problems. Edison was directed to investigate these matters and report the results of these investigations to the staff. The matters were reportedly satisfactorily resolved. The relatively small number of service complaints indicates that a generally high level of service is being provided by Edison.

VIII—OTHER ITEMS

After an examination of Edison's accounting and financial records, together with those of its domestic subsidiaries for the years 1972, 1973, and 1974, staff Financial Examiner II Rene A. Angus expressed criticisms and made recommendations on eleven of Edison's accounting practices as follows:

1. Edison included land cost for CWIP in ADC interest base whereas staff recommends it be maintained in land held for future use until the project is completed. Edison revised its accounting practices to conform to staff's recommendation.

2. Staff recommends an annual reconciliation of general ledger accounts with continuing property records. Edison maintains that such accounting is, from a practical standpoint, neither possible nor necessary and that were it possible it would have no impact on costs borne by ratepayers. We will accept Edison's position on this matter.

3. Staff recommends removal from plant accounts of the abandoned Ormond Beach Generating Station offshore mooring facility and marine oil pipeline. This matter was discussed under the section of this decision relating to rate base.

4. Staff recommends that work orders be credited a fair value for energy produced during test periods instead of just the fuel cost of the energy. Edison takes the position that a higher credit for the energy

would result in higher operating costs with no effect on the ratepayer. Edison's position appears reasonable.

5. Staff recommends that the staff be kept informed of all research and development programs costing over $1 million. Edison asserts it already endeavors to comply with this recommendation.

6. Edison has reportedly already implemented the staff's recommended nuclear fuel reprocessing accounting procedure.

7. Staff recommends that certain dues and donations be excluded from operating expenses and included in Account No. 426, Miscellaneous Income Deductions. These items were considered under expenses and appropriate ratemaking adjustments were made.

8. Staff recommends that the uncollectible reserve be based on six-months' actual write-off. Edison points out that the reserve increase, adjusted in 1974, has no effect on 1976 test year results and need not be considered in this proceeding. We agree.

9. Staff recommends disallowance of "spread-loss" insurance premiums. This matter was resolved under the expense portion of this decision.

10. Staff recommends that future nuclear insurance premiums be reduced by refunds received. The record shows that these refunds were made in 1974 on premiums paid in 1973. A continuation of such premium refunds is problematical and should not be reflected in our 1976 test year results.

11. Staff recommends that we disallow the estimated or actual court settlement involving discrimination in employment practices as an operating expense as such practices are contrary to the social responsibili-

ties of everyone including Edison. This matter was resolved in the expense portion of this decision.

IX—FINDINGS AND CONCLUSION

Findings

1. Southern California Edison Company is in need of additional revenues but the proposed increase of $339 million (21 percent) is excessive.

2. A reasonable rate of return to be applied to Edison's California jurisdictional rate base is 8.8 percent.

3. The 12.63 percent return on common equity included in the computations deriving the above 8.8 percent rate of return is reasonable and includes consideration of the election of Option 2, ratable flowthrough, for the additional investment tax credit allowances permitted by the Tax Reduction Act of 1975.

4. The 12.63 percent return on common equity will provide an interest coverage on Edison's debt of 2.71 times after taxes.

5. The adopted estimates previously discussed herein of operating revenues, operating expenses, and rate base for the test year 1976 reasonably indicate the results of Edison's operations in the near future. Specific findings on some of the more controversial issues are:

a. The adopted California jurisdictional revenues and fossil fuel expenses reflect the base rates and fuel costs established by Decision No. 81919.

b. A lump sum adjustment of $2,052,000 to reflect an 8.5 percent overall wage increase rather than an anticipated 7 percent increase effective January 1, 1976 is reasonable.

c. Edison's announced additional cost reduction program designed to further cut expenses by 5 percent should result in additional savings to Edison of $11,-000,000 for the test year 1976.

d. Edison's estimates of its own hydroproduction, and the staff's estimates of Hoover generation, economy energy purchases, and Pacific Northwest surplus energy are reasonable for the test year 1976.

e. A reasonable allowance for advertising and public relations is $800,000.

f. The "spread-loss" insurance premium of $1,430,-000 is a reasonable amount for inclusion in Edison's operating expenses for the test year 1976.

g. The Vidal write-off of $865,000 a year (one-fifth of the total cost to be amortized) is disallowed.

h. The staff's inclusion of an $11 milliion income tax reduction for repair allowance is reasonable.

i. Edison's selection of Option 2, ratable flow-through, for the increased ITC allowances provided in the TRA of 1975 reduces external financing requirements and thereby reduces investor risk and should be included in our consideration of a proper rate of return.

j. Monies received from governmental agencies for the relocation of electric facilities are properly includable in computing depreciation expense.

k. The inclusion of nonoperative construction work in progress in rate base is adverse to the public interest.

l. The inclusion of replacement plant and plant installed to meet environmental requirements at other than a weighted average basis is an improper ratemaking procedure.

m. The staff's estimate of fossil fuel stock based on 90 days' average requirements with an approximate 25 percent unpaid invoice adjustment is reasonable.

n. The staff's estimate of the savings in distribution plant resulting from Edison's transformer load management program is reasonable.

6. For the purpose of allocating cost and rate base between jurisdictions, the modified peak responsibility method is reasonable.

7. For the purpose of allocating average cost between classes of customers within California jurisdictional operations the MPR method should be used in the future. Marginal cost data should also be developed.

8. Edison's California jurisdictional rates should be increased approximately $122.5 million over its base rates in effect on December 30, 1975 which equates to $44.5 million over the rates authorized by Decision No. 85294 which granted Edison an $80 million partial general rate increase (or $78.1 million on the adopted sales herein). This amounts to a 2.61 percent increase over current revenue including ECAC.

9. The increase in rates and charges authorized by this decision is justified and is reasonable; the present rates and charges, insofar as they differ from those prescribed by the decision, are for the future unjust and unreasonable.

10. The apportionment of the authorized rate increase to the various customer groups as previously described is reasonable.

The Commission concludes that the application should be granted to the extent set forth in the order which follows.

ORDER

IT IS ORDERED that after the effective date of this order, Southern California Edison Company is authorized to file revised rate schedules with rates increased from present levels by .092 cents per kilowatt-hour for all rate schedules. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be two days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date hereof.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 21st day of December, 1976.

I concur in the above ordering paragraph and will file a separate concurring and dissenting opinion.

/s/ WILLIAM SYMONS, JR.
Commissioner

I will file a written concurrence and dissent.

/s/ VERNON L. STURGEON
Commissioner

D. W. HOLMES
President
VERNON L. STURGEON
LEONARD ROSS
Commissioners

Commissioner Robert Batinovich, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Applicant: Rollin E. Woodbury, Robert J. Cahall, William E. Marx, Dennis G. Monge, by *William E. Marx, Dennis G. Monge,* and *Richard K. Durant,* Attorneys at Law.

Protestants: *George Gilmore,* Attorney at Law, *Dr. Eugene Coyle,* and *Sylvia M. Siegel,* for Toward Utility Rate Normalization, Consumers Federation of California, Fight Inflation Together, Energy Reform Group, Citizens of San Bernardino, Upland, etc.; and *Robert D. Rudnick,* Attorney at Law, for POWER (People Outraged With Electric Rates).

Interested Parties: *T. W. Anderson,* and *A. W. Hooton,* for General Portland, Inc., California Division; Best, Best & Krieger, by *Michael D. Harris, Arthur L. Littleworth,* and *Glen E. Stephens,* Attorneys at Law, for Desert Water Agency, City of Palm Springs, Palm Springs Unified School District, Desert Hospital District, and Desert Hot Springs County Water Agency; *Will H. Braunle,* for Safeway Stores, Inc.; Brobeck, Phleger & Harrison, by *Gordon E. Davis, Thomas G. Wood,* Attorneys at Law, and *Robert E. Burt,* for California Manufacturers Association; *Richard D. DeLuce,* Attorney at Law, Edward Sherry, and Dr. Harris Nissel, for Air Products and Chemicals, Inc.; *Frank J. Dorsey,* Attorney at Law, and Daniel J. Reed, for Consumer Interests of the Executive Agency of the United States; Enright, Elliott & Betz, by *Norman Elliott,* Attorney at Law, for Monolith Portland Cement Co. and Committee to Protest California Economy; *Dennis B. Kava-*

nagh, Attorney at Law, for Golden State Mobilhome Owners League; *Paul P. Hendricks,* for City of Vernon; Graham & James, by *Boris H. Lakusta* and *David J. Marchant,* Attorneys at Law, for Western Mobilehome Association; *William L. Knecht* and *William H. Edwards,* Attorneys at Law, for California Farm Bureau Federation; *Arthur Kirgel* and Joe Westmoreland, for City of Riverside; *W. C. Leist* and *R. F. Smith,* for Union Carbide Corp.; Overton, Lyman & Prince, by *Donald H. Ford,* Attorney at Law, for Southwestern Portland Cement Co.; *William M. Pfeiffer* and *David B. Follett,* Attorneys at Law, for Southern California Gas Company; *John R. Phillips,* Attorney at Law, for Planning and Conservation League; Burt Pines, City Attorney, by *Frederick H. Kranz, Jr.,* Attorney at Law, for Los Angeles Department of Water and Power; *Louis Possner,* for City of Long Beach; *Kenneth M. Robinson,* Attorney at Law, and *George B. Scheer,* for Kaiser Steel Corporation; Robert W. Russell, by *Kenneth E. Cude,* for City of Los Angeles; *R. M. Shillito,* for California Retailers Association; *James F. Sorrensen,* for Friant Water Users Association; *John P. Terry,* for Los Angeles Department of Water and Power; Robert P. Will, John M. Davenport, *R. D. Twomey,* and Gerald Winerman, Attorneys at Law, for Metropolitan Water District of Southern California; and *M. Keate Worley,* Attorney at Law, for Texaco, Inc.

Commission Staff: *Timothy E. Treacy,* Attorney at Law, *Robert C. Moeck,* and *Kenneth K. Chew.*

COMMISSIONER VERNON L. STURGEON, Concurring in Part and Dissenting in Part

The return on rate base and the resultant return on common stock equity authorized herein is the product of total disregard of the principles laid down in *Federal Power Commission v Hope Natural Gas Company,* (1944) 320 US 591. I deem this a serious charge as these principles are, without doubt, to utility regulation what Polaris is to navigation.

Change being both inevitable and constant, it is to say the least, disconcerting to witness irresponsible overreaction to it.

There is nothing in this record which warrants adjustment outside of the Hope guidelines.

Rate levels for a straight electric utility authorized to produce a rate of return of 8.8% and a return on common equity of 12.63% will not allow Southern California Edison Company to operate successfully, maintain financial integrity and attract capital. These are the guidelines set forth by Hope and found essential to produce an ". . . end result which will be just and reasonable."

It follows that applicant will not be able to maintain its present high level of service and will not be able to adequately assist in the discovery, development and conservation of energy.

San Francisco, California

December 21, 1976

/s/ Vernon L. Sturgeon
VERNON L. STURGEON
Commissioner

COMMISSIONER WILLIAM SYMONS, JR., Concurring in Part and Dissenting in Part

I concur with the increase approved in the single ordering paragraph insofar as it provides a portion of the financial relief which the facts show is needed and justified; however, I take issue with five major points in the body of discussion: (1) rate of return, (2) construction work in progress, (3) budget for public information, (4) method of cost allocation and rate design and (5) write-off of Vidal Plant. Overall, I judge the resulting level of earnings to be seriously deficient.

1. *Rate of Return*

While not granting Edison's requested 9.6% rate of return, I find the hearing Examiner's proposed 9.2% rate of return more appropriate than the punitive 8.8% adopted here today. The utility's external financing requirements through 1978 are substantially greater than it has experienced in the recent past. With a 9.2% rate of return, the resulting return on capital should meet that minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. Even at the 9.2% rate of return level, we note that the "times interest coverage" of 2.91 which resulted in Edison's last general rate case decision in 1973 (Decision No. 81919) will slip to 2.83.

Insufficient earnings also are signalled by the degree to which the purchase price of common stock has fallen below book value. The probable outcome of today's order with its 8.8% rate of return and a resulting 12.63% return on equity has been known to the investment community for several weeks. That

this return is inadequate may be discerned from the results of the recent sale of Edison common stock. On December 8, 1976, Edison sold 5,000,000 shares of common stock. The price received was about $22/share. This occurred at a time when current book value was over $30/share.

Investment Tax Credit. The reason which really determines this low 8.8% rate of return is not discernible in this decision. Perhaps it is caused by a desire by the majority to rechannel the effects of the Federal Investment Tax Credit. I have dissented from such attempts in the past because they are dangerous and contrary to the policy of Congress. (See Dissenting Opinion to D. 85627, March 30, 1976.) I consider it foolhardy for state regulators to run such a risk where the state's utilities and their customers stand to be the ultimate fall guys. I can understand the terrorized state of the major utilities who fear (1) not just "docking" of millions of dollars in earnings by the California Commission because of the utility's free selection ITC Option 2, but (2) having to pay a second time because the bullying conduct of the California Commission causes the Internal Revenue Service to disallow California companies the 6% investment tax credit. The Commission majority may consider itself safe because it has been imprecise as to the quantitative impact of this consideration (today's Opinion, page 22, also Finding #3, page 103). But if this "enigmatic" approach fails before the IRS, I suspect we will be treated to a further shameful episode in this ITC affair, as the responsible regulators try to push the blame off onto the utility companies.

2. *Nonoperative Construction Work In Progress (NOCWIP)*

Current sizeable increases in (1) construction time, (2) cost of capital, and (3) size of capital projects argue for some inclusion of NOCWIP in rate base. When consideration is given to the tax deductibility of the debt component of return, we have a method of increasing cash flow at the rate of approximately one dollar for every dollar and a half of revenue, a superior method of increasing cash flow. The NOCWIP in rate base also eliminates the discrepancy of the allowance for funds used during construction (ADC) which is currently at the 8% level, where the cost of capital runs in excess of 9%.

Partial inclusion at this time of NOCWIP in rate base would be appropriate and beneficial. It would be a transition from the present future cost payment method to this pay-as-you-go basis, and should be limited initially. For the case at hand and for consideration in later cases, we would do well to follow the policy example of Federal Power Commission Order No. 555 dated November 8, 1976. In that case, NOCWIP related to pollution abatement plant modification was allowed. Rather than the Examiner's proposed $300 million NOCWIP inclusion, pollution-abatement-related NOCWIP per Exhibit 47 in this proceeding would provide a $45 million rate base allowance equivalent to a $7.4 million revenue requirement at a 9.2% rate of return.

3. *Budget for Public Information*

A "smaller ticket" but vital item in this decision is the slashing of the Public Relations/Public Information budget of the utility from approximately $3,800,-

000 down to $800,000. In the public discussion by the Commissioners urging this course, lack of sufficient documentation was the given explanation. Yet, we see emerging from the newly inserted language a thrust not just for documentation, but a blatant attempt to control the content of the information the utility may give to the public in the ordinary course of business. Proceeding in an Orwellian manner, communication of thoughts not specifically permitted is forbidden. On page 51, only informational advertising expense of $10,000 for kite safety messages and $40,000 in notices of financial offerings are allowed. Conservation messages are also allowed. But specifically excluded, even though neither the P.U.C. staff nor hearing Examiner recommend it, were $400,000 for plant safety and siting advertising or $150,000 for a discussion of viable future energy sources.

Why should the public be cut off from discussion of viable future energy sources by the energy utilities? It doesn't make sense. However, if we recall that special political interest groups have sought to silence the utilities, and that certain Commissioners have expressed ire at utility discussions of Nuclear Power, we can see that what may not be good government may be "good" politics. This whole area is too important to allow government power to be used to stifle full public discussion. Further attention will have to be paid to exactly what is in the "guidelines" the government is imposing.

4. *Method of Cost Allocation and Rate Design*

Greater care must be given to cost allocation and rate design. I agree with the Examiner's recommendation that we maintain the use of the Monthly Peak

Responsibility method for jurisdictional allocations and the Load Factor Diversity Factor method for California jurisdictional allocations. The decision on rate spread is made less crucial by the fact it is balanced by a simultaneous rate reduction due to the operation of the energy cost adjustment clause. Yet, simply hiking rates on a uniform cent-per-kilowatt hour ignores relating prices to actual costs. Testimony, such as Mr. Reed for the California Manufacturers' Association, that present domestic rates in the Edison system as authorized by Decision No. 85294 are insufficient to meet the out-of-pocket cost to serve for usages under 1,500 Kwhr a month which includes 98.8% of the bills rendered by the utility, should ring an alarm bell. We must have rates where each class—residential, commercial, industrial or other—pulls their own weight as to costs. "Lifeline", "welfare" or "income redistribution" rates can spell doom for the economic future of California with farm products too expensive to market, and business and jobs driven from California.

5. *Write-off of Vidal Plant*

The amortization of the Vidal nuclear generating station is another victim of alleged insufficient documentation, though the hearing Examiner did not so find. On this point it should be noted that the staff did not testify against the propriety of the write-off, assuming cost savings information was available. Today's decision is too terse concerning the future course the Commission intends to take regarding this expense.

I would have added to the discussion by noting that the Commission does not intend to preclude subsequent relief on this point in a special proceeding where further documentation and evaluation will be possible.

San Francisco, California

December 21, 1976

WILLIAM SYMONS, JR.
Commissioner

APPENDIX 2.

Decision No. 87828 (9/7/77).

Decision No. 87828

September 7, 1977

Before the Public Utilities Commission of the State of California.

In the matter of the application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

Rollin E. Woodbury, Robert J. Cahall, William E. Marx, and Dennis G. Monge, by *Rollin E. Woodbury* and *William E. Marx,* Attorneys at Law, for applicant.

Jonel C. Hill and David B. Follett, by *Robert M. Loch,* Attorney at Law, for Southern California Gas Company; Burt Pines, City Attorney, by *Leonard L. Snaider,* Deputy City Attorney, for City of Los Angeles; Robert W. Russell, by *Manuel Kroman,* Attorney at Law, for Department of Public Utilities and Transportation, City of Los Angeles; *Robert W. Schempp,* for Metropolitan Water District of Southern California; and John W. Witt, City Attorney, by *William S. Shaffran,* Deputy City Attorney, for City of San Diego; interested parties.

Timothy E. Treacy, Attorney at Law, and *Kenneth J. Kindblad,* for the Commission staff.

OPINION ON REHEARING AND REOPENING

Decision No. 86794 dated December 21, 1976 was issued on the above subject application after 102 days of public hearing. It authorized rates intended to provide Southern California Edison Company (Edison) an increase of approximately $122.5 million for its California jurisdiction rates for the test year 1976 and provide a rate of return of 8.8 percent on the adopted California jurisdictional rate base and a return on common equity of 12.63 percent. On January 7, 1977 Edison petitioned for rehearing of D.86794 or for reconsideration and modification thereof. D.86986 dated February 15, 1977 granted a rehearing limited to the issue of the manner in which certain items of replacement plant and plant installed by end of year 1976 to meet environmental requirements (designated "Special Items—Nonweighted" in this proceeding) should be included in rate base. On February 22, 1977 Edison filed a petition for rehearing and reconsideration of D.86794 and D.86986 and for reopening of the record to take additional evidence. D.87088 dated March 15, 1977 denied the petition to rehear and reconsider but based on the facts and argument set forth in the petition, granted the petition to reopen the proceeding to take further evidence on the issues relating to the investment tax credit (ITC) and rate of return pursuant to Section 1708 of the Public Utilities Code. Public hearings on these two matters were held before Administrative Law Judge Norman R. Johnson in Los Angeles on May 16, 17, 18, and 19, 1977 and June 8 and 9, 1977, and the matters were submitted on the receipt of concurrent

opening briefs due July 11, 1977 and concurrent closing briefs due July 18, 1977.

Opening briefs were received from Edison, the Commission staff, and jointly from the city of Los Angeles and the city of San Diego (Cities), and reply briefs were received from Edison and the Commission staff. Proposed transcript corrections were forwarded by Edison by a letter dated June 16, 1977. These transcript corrections appear valid and are hereby accepted. Testimony was presented on behalf of Edison by a consulting attorney, by its assistant comptroller, by one of its senior plant appraisers, and by its manager of regulatory costs, and on behalf of the Commission staff by one of its engineers. Other parties to the proceeding participated by cross-examination of the various witnesses.

I—INVESTMENT TAX CREDIT

Background

As discussed in D.86794 the Tax Reduction Act of 1975 (TRA) signed into law by the President on March 29, 1975 provides, among other things, for an increase in the ITC rate from four percent to 10 percent for new qualified plant. TRA further provided that utilities, such as Edison that were using flow-through tax depreciation accounting, elect by June 25, 1975 one of the following three options:

Option 1: Reduction of rate base with a pro rata restoration each year.

Option 2: Immediate credit to income taxes which is flowed through on a pro rata basis over the life of the property (ratable flow-through).

Option 3: Immediate flow-through of the full amount of the credit (full flow-through).

Edison's election of Option 2, ratable flow-through, was discussed in detail on the record and was one of the myriad considerations in our deliberations on this matter as evidenced by the following quotes from D.86794:

> "Another factor for consideration in arriving at the proper rate of return level is the additional investment tax credit benefits accruing to Edison as a result of the Tax Reduction Act of 1975 (TRA). The record shows that Edison elected Option 2, ratable flow-through, for the additional 6 percent investment tax credit provided for by TRA. In Decision No. 85627 dated March 30, 1976 on Southern California Gas Company's Applications Nos. 55676 and 55544 and San Diego Gas & Electric Company's Applications Nos. 55677 and 55543 in a similar situation, we found as follows: '5. A rate of return adjustment downward of 0.25 percent on an $824.5 million rate base will best recognize the reduction in risk claimed by SoCal in its choice of Option 2.' Similarly in *Re SoCal Gas Co.*, Decision No. 86595 dated November 2, 1976 in Application No. 55345 at page 96, we recognized 'that because of SoCal's election of Option II, cash flow would be maximized, interest coverage increased, and the financial requirements in constructing facilities and acquiring gas supplies relieved.' The corresponding reduction in risk redounding to Edison from its election of Option 2 was included in

our considerations in arriving at our adopted rate of return." (Mimeo. page 22.)

* * *

"3. The 12.63 percent return on common equity included in the computations deriving the above 8.8 percent rate of return is reasonable and includes consideration of the election of Option 2, ratable flow-through for the additional investment tax credit allowances permitted by the Tax Reduction Act of 1975." (Mimeo. page 103.)

* * *

"i. Edison's selection of Option 2, ratable flow-through, for the increased ITC allowances provided in the TRA of 1975 reduces external financing requirements and thereby reduces investor risk and should be included in our consideration of a proper rate of return." (Mimeo. page 105.)

TRA provides limitations in the case of regulated companies that have selected ratable flow-through as set forth in the Internal Revenue Code Section 46(f) as follows:

"(2) Special rules for ratable flow-through.—If the taxpayer makes an election under this paragraph within 90 days after the date of enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer—

"(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more

than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

"(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)."

Edison interpreted the above quoted D.86794 excerpts as an indication that possibly increased ITC benefits were to be faster than ratably flowed through to the ratepayer and sought the advice of independent outside legal counsel with special expertise in this area to evaluate whether the availability of the additional ITC benefits was jeopardized by our treatment of this issue in D.86794. It was this counsel's opinion that our treatment of the ITC issue will seriously jeopardize Edison's ability to avail itself of these increased ITC benefits for all open tax years as well as for the future and formed the basis for Edison's petition for reopening of the record to take additional evidence.

Edison's Position

Edison's position, presented into evidence by an outside legal counsel, K. William Kolbe, and by Edison's assistant comptroller, C. S. Reenders, is that our consideration of the reduction in risk redounding to Edison from its election of Option 2 in arriving at a reasonable rate of return might possibly be construed by IRS as an impermissible indirect reduction in rate base resulting in Edison's loss of eligibility for the additional ITC benefits provided by TRA of 1975; that unless this Commission treated the unamortized investment credit as common equity, Edison's eligibility for the

additional ITC benefits is in jeopardy; and that for Edison to retain its eligibility it is necessary for this Commission to restore any reduction in rate of return made as a result of Edison's election of Option 2 and to either indicate that we treated the unamortized investment tax credit as shareholder capital in arriving at the adopted capital structure or change the capital structure to reflect unamortized tax credit as shareholder capital. Mr. Kolbe's testimony encompassed the concept that loss of eligibility of the additional ITC benefits would result from any accounting treatment that could directly or indirectly reduce the cost of service for ratemaking purposes by more than a ratable portion of the allowable credit or directly or indirectly apply the credit to reduce the base to which the taxpayer's rate of return is applied for ratemaking purposes. The testimony indicated then any adjustment to rate of return will constitute such an indirect rate base adjustment. In support of this position he quoted from Senate Report No. 92-437, 92nd Cong., 1st Sess., 1972-1 C.B. 559, 580, as follows:

> "'In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect the Company's permitted profit on investment by treating the credit in any way other than as though it had been contributed by the company's common shareholders. For example, if the "cost of capital" rate assigned to the credit is less than that assigned to common shareholders' investment, that would be treated as, in effect, a rate base adjustment.'"

According to the testimony, the above-quoted language also requires that a commission which applies a rate

of return based on embedded average cost of capital must include the unamortized investment credits as a component of equity capital and assign to such capital the same rate of return assignable to other equity capital in deriving the rate of return applied to total rate base.

In addition, Mr. Kolbe sponsored as exhibits one IRS ruling and two IRS information letters which he believes fully support his position on this matter.

The IRS ruling relates to our D.85627 dated November 2, 1976 in Southern California Gas Company's (SoCal) A.55345 in which we recognize the reduced risk associated with SoCal's election of Option 2 by a downward rate of return adjustment of 0.25 percent on an $824.5 million rate base. The IRS ruling states that should D.85627 stand as the final determination[1] within the meaning of the term in Section 46(f)(4)(c) of the Internal Revenue Code, the decision would contravene the provisions of Section 46(f)(2) with the resultant loss of eligibility for the increased ITC benefits because such a rate of return adjustment would have placed SoCal in a position similar to its position had it elected full flow-through and, further, there is no support in the decision that the adjustment bears any reasonable relationship to SoCal's more favorable position for attracting debt and equity financing.

The two information letters sponsored as exhibits by Mr. Kolbe relate to regulatory action by the Department of Public Utilities, city of Dallas, Texas, in one case and the Public Service Commission of New Mexico in the second case. The city of Dallas information

[1]Section 46(f)(4)(c)(i): ". . . a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed."

letter inquired as to the effect on the additional ITC availability were a ratemaking order issued requiring one-half of the authorized rate of return applied to the unamortized investment tax credit be flowed through to income for the benefit of the company's ratepayers.

The IRS information letter to the Public Service Commission of New Mexico relates to the utility's proposed ratemaking procedure of including the reserve for accumulated deferred ITC with the common stock for the derivation of the company's composite capital structure for use by that Commission in the determination of an overall rate of return to be applied to the utility rate base. The letter writer concluded that in determining the overall cost of capital of a utility for ratemaking purposes, deferred ITC's are properly to be included and assigned a return not less than that considered applicable to common equity.

Commission Staff's Position

It is the staff's position that the appropriate ratemaking treatment of accelerated tax depreciation and ITC, where taxes far in excess of taxes actually paid are used for ratemaking purposes has been heretofore presented to the California Supreme Court which stated "Alternatively the commission could choose to mitigate the windfall accruing to real parties in interest in consequence of their failure to elect accelerated depreciation prior to 1969 by setting more modest rates of return in recognition of the additional source of capital available to the utilities by virtue of the federal tax laws." (*City of Los Angeles v Public Utilities Commission* (1975) 15 C 3d 680, 704, fn. 42); that our consideration of risk as affected by the election of Option 2 or use of accelerated depreciation in the

fixing of rate of return was not challenged by either Southern California Gas Company in connection with D.85627 on A.55677 and A.55544 or Pacific Telephone and Telegraph Company in connection with D.53540 in A.53887; that our treatment of ITC will not imperil Edison's eligibility because Congress clearly knew the distinction between rate base and rate of return and incorporated no restriction on rate of return in Section 46(f)(2)(A) or (B); that a private letter ruling involving a different utility, such as the gas company, cannot be used by the IRS as an authority to challenge Edison's eligibility for the additional ITC; and that the inclusion of unamortized ITC with the resulting increased cost of capital would place an added burden upon ratepayers contrary to the Congressional intention to share the tax savings between the utility and its customers.

Cities' Position

Cities' position on ITC as set forth in the jointly filed brief is that guidance from the California Supreme Court in *City of Los Angeles v Public Utilities Commission* (1975) 15 C 3d 680 indicates that efforts of regulatory bodies to pass the benefits of reduced tax expenses on to the utilities' ratepayers are mandatory for a state agency charged with insuring that no public utility shall receive any unjustified rate increases; that this Commission's rate of return adjustment is not inconsistent with current tax law; that similar ratemaking treatment set forth in D.83540 on Pacific Telephone and Telegraph Company (PT&T) was not challenged by either PT&T or IRS; and that the Tax Code precludes the use of cost-of-service and/or rate base adjustments to negate the benefits of ITC, but

imposes no such constraints on adjustments to the rate of return.

Discussion

The issues involving ITC in this reopened proceeding that require resolution are as follows:

1. Did this Commission, after determining that Edison's overall risk position supports a certain rate of return, make a downward adjustment to that rate of return to reflect Edison's election of Option 2?

2. Does a downward adjustment in the rate of return constitute an indirect adjustment in rate base rendering a utility ineligible for the additional ITC benefits provided by the TRA of 1975?

3. Is it Congressional intent that unamortized ITC be treated as equity capital available to utilities such as those subject to this Commission's jurisdiction where rate base consists of original cost depreciated plant rather than its capital investment?

4. What weight, if any, should be given the private IRS ruling to Southern California Gas Company and the two information letters to the city of Dallas and the Public Service Commission of New Mexico in this matter?

5. Does the ratemaking guidance set forth by the California Supreme Court in *City of Los Angeles v Public Utilities Commission* mandate the establishment of a more modest rate of return in recognition of the additional source of capital available to Edison because of its election of Option 2?

D.86794 states in part: "After careful consideration of all the previously discussed relevant factors in the development of a reasonable return on common equity

we adopt as reasonable a return on equity of 12.63 percent which, applied to our adopted capital structure and costs, translates to a rate of return of 8.8 percent . . ." (Mimeo, page 23.) These previously discussed relevant factors include the cost of money, Edison's capital structure as compared to other similar utilities, interest coverage ratios, price/earnngs ratios, price/book ratios, future financing requirements, the level of earnings required to restore common stock sale price to at least book cost, and, of course, the effect of the additional investment tax benefits accruing to Edison as a result of its election of Option 2. In other words, all the relevant factors, including Option 2 benefits, were considered as a whole. We did not, contrary to Edison's construction of the language of the decision, arrive at a reasonable return on equity exclusive of Option 2 benefits and then adjust the figure downward to reflect the Option 2 benefits. Option 2 benefits were specifically mentioned as being included in our considerations because the effect of Edison's election of Option 2 was a major issue in the proceeding and not because, as Edison believes, a specific downward adjustment was made to our derived reasonable rate of return.

In any event, we are not persuaded that a downward adjustment in rate of return of utilities subject to our jurisdiction is an indirect adjustment to rate base as contended by Edison's witnesses. Section 46(f)(2) is quite specific in the constraints on eligibility for those ratepayers electing Option 2, ratable flow-through. Loss of eligibility occurs if the taxpayer's cost-of-service for ratemaking purposes is reduced by more than a ratable portion of the allowable credit or "If the base to which the taxpayer's rate of return for ratemaking

purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)." Congressional committee reports and proposed regulations[2] explain the use of the credit to reduce cost-of-service as any accounting treatment that can affect cost-of-service and cite as examples the use of the investment credit to reduce ratemaking federal income tax and the reduction, by the amount of the credit, of the depreciable basis of the property on the regulated books of account. It is clear from the record that neither such adjustment is contemplated in this proceeding.

With respect to rate base reductions, the committee reports make reference to any accounting treatment that can affect the company's permitted profit on investment by treating the credit in any way other than as though it had been contributed by the company's common shareholders and cite as an example of such an impermissible adjustment the assignment of a lesser cost of capital to the credit as being the equivalent of a rate base adjustment. Inasmuch as treating unamortized investment tax credit as though it had been contributed by the common shareholder is in direct conflict with the Uniform System of Accounts[3] prescribed by the Federal Power Commission and adopted by numerous utility regulatory agencies, it is obvious that the congressional committees were concerned only with ratemaking accounting treatment. Furthermore, con-

[2]House Report No. 92-533, 92nd Cong., 1st Sess., 1972-1 C.B. 498,511; Senate Report No. 92-437, 92nd Cong., 1st Sess., 1972-1 C.B. 559, 580; Proposed Regulations Section 1.46-5(A).

[3]Common stock transactions are recorded under proprietary capital accounts whereas accumulated deferred investment tax credits are in Account 255 under Deferred Credits.

strictions on regulatory agency actions of necessity are broad-based to encompass all of the varying practices and concepts of the numerous regulatory agencies throughout the country. There are several so-called fair value oriented regulatory agencies who use as rate base[4] either the utility's actual capitalization or a fair value rate base derived from a weighting process based on the percentage of common equity in the capital structure. In either case the inclusion of unamortized ITC in common equity at a return on equity less than that applied to the common shareholder's equity rate would dilute the indicated revenue requirement relative to such a requirement exclusive of the unamortized ITC. It is just such an effect the restrictions were intended to contravene. Such restrictions, however, are completely inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure. The unamortized ITC does, however, serve as a source of internal financing and will, therefore, eventually find its way into rate base in the form of capital additions.

The 1976 Tax Reform Act made private IRS rulings, such as the one relating to SoCal introduced into evidence in this proceeding, available for inspection and copying by the public beginning with rulings requested after October 31, 1976. However, the act bars the use of such letter rulings as a precedent unless Treasury regulations otherwise specify that a particular

[4]Proposed Regulations Section 1.40-5(b)(3)—Rate Base—For purposes of this section, the term "rate base" means the base to which the taxpayer's rate of return for ratemaking purposes is applied.

ruling or rulings may be used as a precedent. This bar to precedential value of private rulings applies to the IRS as well as taxpayers. Under these circumstances, this letter would be of limited use in the resolution of the instant proceeding even if, as Edison erroneously believes, it is possible to interpret the language in our decision as stating that a downward adjustment was made to our derived reasonable rate of return to negate the effect of Edison's election of Option 2.

IRS information letters are provided in the interest of sound tax administration in answer to inquiries by individuals and organizations. Such letters purportedly do no more than call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts.

The IRS information letter sent to the city of Dallas Department of Public Utilities relates to the jeopardizing of the availability of the additional ITC benefits of TRA if a ratemaking order issued requiring that one-half of the authorized rate of return on the utility rate base attributable to ITC were to be flowed through to income for the benefit of the ratepayers. From the information letter it would appear that the physical means of effecting the proposed ratemaking treatment would be to flow through as income an amount equal to 3.5 percent of the unamortized ITC in addition to the ratable flow-through amount or, alternately, to deduct one-half of the unamortized ITC from rate base. It is obvious that the former is cost-of-service reduction as contemplated in Section 46(f)(2)(A) and the latter is a rate base reduction as contemplated in Section 46(f)(2)(B) with the result that the utility would lose

its eligibility for the additional ITC. It is equally obvious that either the contemplated cost-of-service reduction or direct rate base reduction is completely dissimilar to the ratemaking considerations being contemplated herein.

The second IRS information letter relates to the inclusion of unamortized ITC in common stock for the derivation of the composite capital structure for a rate proceeding before the Public Service Commission of New Mexico. New Mexico is classified as a fair value state (see 54 *Public Utilities Fortnightly* 563, October 28, 1954). Under these circumstances it is possible that the dollar amount of the rate base of the utility in question could be affected by the inclusion or exclusion of unamortized ITC in equity capital and the revenue requirement could be affected by the return applied to such unamortized ITC. Neither circumstance would be applicable to utilities subject to this Commission's jurisdiction.

Both the Commission staff and Cities quoted in their briefs the following from a California Supreme Court decision:

> "Alternatively, the commission could choose to mitigate the 'windfall' accruing to real parties in interest in consequence of their failure to elect accelerated depreciation prior to 1969 by setting more modest rates of return in recognition of the additional source of capital available to utilities by virtue of the federal tax laws." (*City of Los Angeles v Public Utilities Commission* (1975) 15 C 3d 680, 704, fn 42.)

The establishment of a more modest rate of return was one of several alternatives listed by the California

Supreme Court as available to remedy a serious problem perceived by the Commission. The first sentence of footnote 42 states: "In this connection we emphasize that nothing in the course of this opinion should be construed as binding the Public Utilities Commission either now or in the future to any *particular* method of ratesetting which it decides is not useful." It is obvious that the Supreme Court neither mandates nor prohibits the establishment of a lesser rate of return to reflect additional capital available through federal tax laws.

II—RATE BASE ISSUE

Background

D.86986 dated February 15, 1977 was an order granting rehearing of D.86794 limited to reconsideration of the issue of the manner in which certain items of replacement plant and plant installed by end of year 1976 to meet environmental requirements (denominated "Special Items—Nonweighted" in this proceeding) should be included in rate base. These items have historically been included in rate base on a weighted average basis. D.86794 stated in part:

> "These replacement items, consisting generally of deteriorated distribution plant, storm damaged items, and overhead-to-underground conversion projects, appear to have relatively short construction periods and, therefore, no departure from past practices appears justified. Also lacking in this record is convincing evidence that justifies special treatment of environmental items as contrasted with other NOCWIP. Consequently, the special items will be included in the ADC base until completed and placed in service when they will be included in rate base on a weighted average basis as has been done historically." (Mimeo. page 79.)

In its petition for rehearing Edison noted that this plant which does not contribute to the increased capacity was, according to the uncontradicted record, to be in service by the end of the test year and suggested that it be more appropriate to reflect the revenue requirements associated with such plant in the base rate increase authorized by D.86794 rather than require Edison to file a new and separate application.

Edison's Position

Edison's position, presented into evidence by a senior plant appraiser, is that environmental and replacement plant do not contribute to increased system capacity, nor are they associated with increased load or kilowatt-hour sales or revenues and, therefore, should be included in rate base at full value as nearly as possible to the time the plant comes on line. According to this witness' testimony, the weighted average calculation for rate base traditionally matches investment with associated revenues and revenue requirements, but this theory does not apply to replacement and environmental plant which does not provide increased revenues to cover carrying costs associated with such investment. The replacement items related to distribution line plant and the environmental items consist of air and water pollution control facilities, solid waste disposal costs, noise abatement equipment, and aesthetic costs. The record shows that the nonweighted amount for these items is $37.2 million which translates to a California jurisdictional revenue requirement of $6,935,000.

Commission Staff's Position

The Commission staff's position, as presented into evidence by one of its utilities engineers, is that there is no basis to treating "Special Items" differently than any other additions to rate base. He testified that it is very difficult to draw a line between environmental and nonenvironmental portions of a project being constructed and, in any event, environmental costs associated with a project are part of the costs of the project and should not be treated any differently than the other project costs in the determination of the rate base.

Discussion

The record discloses that the three largest items totaling $32.8 million out of the $37.2 million consist of replacement of deteriorated or damaged equipment, $5.7 million; undergrounding under Rule No. 20, $4.4 million; and the difference between overhead and underground distribution facilities, $22.7 million. Such items are included in the weighted average balances for CWIP for the application of ADC. When placed into service they are removed from the ADC base and included in the weighted average plant balances. They are essential for the maintenance and/or increase of system capacity and warrant the same treatment as other plant. In addition, treating this plant as requested by Edison would result in its inclusion in both the ADC base and rate base for a portion of the year to the detriment of the ratepayer.

In both its petition for rehearing and brief on the rehearing, Edison noted our reference to our recent decision concerning Pacific Gas & Electric Company

(PG&E) (D.86281 dated August 24, 1976 in A.55509) suggesting possible alternatives, especially one that would expedite the inclusion in rate base of plant as it comes on line, and suggested that the inclusion of "Special Items — Nonweighted" in rate base at this time would be such an alternative. The early inclusion in rate base of plant as it comes on line referred to in D.86281 and D.86794 relates to the exclusion of nonoperative construction work in progress (NOCWIP) of approximately $400 million. Needless to say, the effect on utility rates of excluding or including such an amount in rate base is far greater than the effect of the "Special Items" under consideration in this proceeding.

Findings

1. Relevant factors such as the cost of money, Edison's comparative capital structure, interest coverage ratios, price/earnings ratios, price/book ratios, future financing requirements, the level of earnings required to restore common stock sale price to book value, and the effect of additional investment tax benefits accruing to Edison as a result of its election of Option 2 were considered as a whole in arriving at a reasonable return on equity and rate of return to allow Edison.

2. Edison's cost-of-service for ratemaking purposes was not directly or indirectly reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to IRC subsection 46(f)(2)(A)).

3. Edison's rate base for ratemaking purposes is not directly or indirectly reduced by reason of any portion of the credit allowable by section 38 (determined without regard to IRC subsection 46(f)(2)(B)).

4. The California Supreme Court in *City of Los Angeles v Public Utilities Commission* (1975) 15 C 3d 680, fn 42, neither mandated nor prohibited the establishment of a more modest rate of return in recognition of the additional source of capital available to Edison by virtue of the additional ITC provided by the TRA of 1975.

5. The inclusion of unamortized ITC as equity capital is required only for regulatory agencies that utilize capital structure in deriving rate base and not for regulatory agencies, such as this Commission, that derive rate base from the weighted average depreciated plant balances.

6. The 1976 Tax Reform Act prohibits the use of private IRS rulings as a precedent unless Treasury regulations otherwise specify that a particular ruling or rulings may be used as a precedent.

7. The IRS information letters sent to the city of Dallas Department of Public Utilities and the Public Service Commission of New Mexico describe the application of Sections 46(f)(2)(A) and (B) of the Internal Revenue Code to situations that are not paralleled in the instant proceeding.

8. Replacement plant or plant installed for environmental purposes, designated in this proceeding as "Special Items—Nonweighted", should be included in rate base on a weighted average balance basis.

Conclusions

1. The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable rate of return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975.

2. The inclusion of unamortized ITC as equity capital is required only for regulatory agencies that utilize capital structures in deriving rate base and not for regulatory agencies, such as this Commission, that derive rate base from the weighted average depreciated plant balances.

3. Replacement plant or plant installed for environmental purposes designated in this proceeding as "Special Items—Nonweighted" should be included in rate base on a weighted average balance basis.

4. The relief requested should be denied.

ORDER

IT IS ORDERED that Decision No. 86794 is affirmed.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 7th day of September, 1977.

I will file a dissent.

/s/ WILLIAM SYMONS, JR.
Commissioner

ROBERT BATINOVICH
President

RICHARD D. GRAVELLE
CLAIRE T. DEDRICK
Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

Certified as a True Copy of the Original
/s/ Margaret L. McKee
Asst. Executive Director, Public Utilities Commission
State of California

COMMISSIONER WILLIAM SYMONS, JR., DISSENTING

I have reviewed the language in the above case on rehearing. The majority uses quibbling language in this new document called an Opinion.

There is no question about it and it is absolutely clear that Decision No. 86794 in Application No. 54946 adjusted the rate of return downward because of Option 2 Benefits of I.T.C. (See page 3 and 4 of Opinion). In Decision No. 86794, we cited Southern California Gas Company where we adjusted rates downward. Then we said or spoke of a "corresponding" drop for Southern California Edison Company. This clearly implies a corresponding treatment. Yet the Opinion before us goes on and on to say that we didn't determine a rate of return for Edison and then drop or lower rates. Instead it says we considered the effects of the I.T.C. during our rate of return determination rather than after. I feel certain this is contrary to the facts and I believe it to be untruthful.

The consequences of the Commission majority's actions must be allowed to surface or come home to roost. The sad part is the extra money that will be unnecessarily paid by the ratepayers.

The citizenry needs to be alerted as to who the commissioners are that will be responsible for unnecessary future costs. This may be stiff medicine, but now is the time to administer it while the patients still have some pulse and can realize their plight.

The effect of other cases must be weighed also, including the Pacific Telephone and Telegraph Company case. I stick by my original concurring and dis-

senting opinion, dated December 21, 1976 (attached) and I again dissent for the following reasons:

1. There must be honesty and integrity in accepting a Commission appointment. Because of the Oath of Office I swore to in the high position I hold as a Public Utilities Commissioner, I must uphold and enforce the law to the best of my ability;
2. Because of the impact this will have on future cases before the Public Utilities Commission;
3. Because of the impact it will have on the PT&T case that has been on the Commission Agenda since April 1977;
4. The majority of this Commission must face reality and realize we are not a nation of men, but a nation of laws. Our actions ought not to be directed by what our duly appointed officials think, but by what our laws mandate. When government officials attempt to interline our government laws with paternalistic dicta, no matter how benevolent or well-meaning, they vitiate the contractual obligations between the American people and their government, as ordained by the Constitution of the United States of America.

San Francisco, California

September 7, 1977

/s/ William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner

Attachment

COMMISSIONER WILLIAM SYMONS, JR., Concurring in Part and Dissenting in Part

I concur with the increase approved in the single ordering paragraph insofar as it provides a portion of the financial relief which the facts show is needed and justified; however, I take issue with five major points in the body of discussion: (1) rate of return, (2) construction work in progress, (3) budget for public information, (4) method of cost allocation and rate design and (5) write-off of Vidal Plant. Overall, I judge the resulting level of earnings to be seriously deficient.

1. *Rate of Return*

While not granting Edison's requested 9.6% rate of return, I find the hearing Examiner's proposed 9.2% rate of return more appropriate than the punitive 8.8% adopted here today. The utility's external financing requirements through 1978 are substantially greater than it has experienced in the recent past. With a 9.2% rate of return, the resulting return on capital should meet that minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. Even at the 9.2% rate of return level, we note that the "times interest coverage" of 2.91 which resulted in Edison's last general rate case decision in 1973 (Decision No. 81919) will slip to 2.83.

Insufficient earnings also are signalled by the degree to which the purchase price of common stock has fallen below book value. The probable outcome of today's order with its 8.8% rate of return and a resulting 12.63% return on equity has been known to the investment community for several weeks. That

this return is inadequate may be discerned from the results of the recent sale of Edison common stock. On December 8, 1976, Edison sold 5,000,000 shares of common stock. The price received was about $22/share. This occurred at a time when current book value was over $30/share.

Investment Tax Credit. The reason which really determines this low 8.8% rate of return is not discernible in this decision. Perhaps it is caused by a desire by the majority to rechannel the effects of the Federal Investment Tax Credit. I have dissented from such attempts in the past because they are dangerous and contrary to the policy of Congress. (See Dissenting Opinion to D. 85627, March 30, 1976.) I consider it foolhardy for state regulators to run such a risk where the state's utilities and their customers stand to be the ultimate fall guys. I can understand the terrorized state of the major utilities who fear (1) not just "docking" of millions of dollars in earnings by the California Commission because of the utility's free selection ITC Option 2, but (2) having to pay a second time because the bullying conduct of the California Commission causes the Internal Revenue Service to disallow California companies the 6% investment tax credit. The Commission majority may consider itself safe because it has been imprecise as to the quantitative impact of this consideration (today's Opinion, page 22, also Finding #3, page 103). But if this "enigmatic" approach fails before the IRS, I suspect we will be treated to a further shameful episode in this ITC affair, as the responsible regulators try to push the blame off onto the utility companies.

2. *Nonoperative Construction Work In Progress (NOCWIP)*

Current sizeable increases in (1) construction time, (2) cost of capital, and (3) size of capital projects argue for some inclusion of NOCWIP in rate base. When consideration is given to the tax deductibility of the debt component of return, we have a method of increasing cash flow at the rate of approximately one dollar for every dollar and a half of revenue, a superior method of increasing cash flow. The NOCWIP in rate base also eliminates the discrepancy of the allowance for funds used during construction (ADC) which is currently at the 8% level, where the cost of capital runs in excess of 9%.

Partial inclusion at this time of NOCWIP in rate base would be appropriate and beneficial. It would be a transition from the present future cost payment method to this pay-as-you-go basis, and should be limited initially. For the case at hand and for consideration in later cases, we would do well to follow the policy example of Federal Power Commission Order No. 555 dated November 8, 1976. In that case, NOCWIP related to pollution abatement plant modification was allowed. Rather than the Examiner's proposed $300 million NOCWIP inclusion, pollution-abatement-related NOCWIP per Exhibit 47 in this proceeding would provide a $45 million rate base allowance equivalent to a $7.4 million revenue requirement at a 9.2% rate of return.

3. *Budget for Public Information*

A "smaller ticket" but vital item in this decision is the slashing of the Public Relations/Public Information budget of the utility from approximately $3,800,-

000 down to $800,000. In the public discussion by the Commissioners urging this course, lack of sufficient documentation was the given explanation. Yet, we see emerging from the newly inserted language a thrust not just for documentation, but a blatant attempt to control the content of the information the utility may give to the public in the ordinary course of business. Proceeding in an Orwellian manner, communication of thoughts not specifically permitted is forbidden. On page 51, only informational advertising expense of $10,-000 for kite safety messages and $40,000 in notices of financial offerings are allowed. Conservation messages are also allowed. But specifically excluded, even though neither the P.U.C. staff nor hearing Examiner recommended it, were $400,000 for plant safety and siting advertising or $150,000 for a discussion of viable future energy sources.

Why should the public be cut off from discussion of viable future energy sources by the energy utilities? It doesn't make sense. However, if we recall that special political interest groups have sought to silence the utilities, and that certain Commissioners have expressed ire at utility discussions of Nuclear Power, we can see that what may not be good government may be "good" politics. This whole area is too important to allow government power to be used to stifle full public discussion. Further attention will have to be paid to exactly what is in the "guidelines" the government is imposing.

4. *Method of Cost Allocation and Rate Design*

Greater care must be given to cost allocation and rate design. I agree with the Examiner's recommendation that we maintain the use of the Monthly Peak

Responsibility method for jurisdictional allocations and the Load Factor Diversity Factor method for California jurisdictional allocations. The decision on rate spread is made less crucial by the fact it is balanced by a simultaneous rate reduction due to the operation of the energy cost adjustment clause. Yet, simply hiking rates on a uniform cent-per-kilowatt hour ignores relating prices to actual costs. Testimony, such as Mr. Reed for the California Manufacturers' Association, that present domestic rates in the Edison system as authorized by Decision No. 85294 are insufficient to meet the out-of-pocket cost to serve for usages under 1,500 Kwhr a month which includes 98.8% of the bills rendered by the utility, should ring an alarm bell. We must have rates where each class—residential, commercial, industrial or other—pulls their own weight as to costs. "Lifeline", "welfare" or "income redistribution" rates can spell doom for the economic future of California with farm products too expensive to market, and business and jobs driven from California.

5. *Write-off of Vidal Plant*

The amortization of the Vidal nuclear generating station is another victim of alleged insufficient documentation, though the hearing Examiner did not so find. On this point it should be noted that the staff did not testify against the propriety of the write-off, assuming cost savings information was available. Today's decision is too terse concerning the future course the Commission intends to take regarding this expense. I would have added to the discussion by noting that the Commission does not intend to preclude subsequent

relief on this point in a special proceeding where further documentation and evaluation will be possible.

San Francisco, California

December 21, 1976

/s/ William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner

APPENDIX 3.

Notice of Appeal to the Supreme Court of the United States (Filed October 16, 1978).

Before the Public Utilities Commission of the State of California.

SUPREME COURT OF THE UNITED STATES

TO THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, being at the relevant times the members of said Public Utilities Commission, AND TO JANICE E. KERR, HECTOR ANNINOS and TIMOTHY E. TREACY, THEIR ATTORNEYS:

NOTICE IS HEREBY GIVEN that Southern California Edison Company hereby appeals to the United States Supreme Court, from the final judgments of the Supreme Court of the State of California entered in two integrally related cases entitled *Southern California Edison Company v. Public Utilities Commission, et al.* (S.F. Numbers 23605 and 23723), on July 19, 1978 denying petitions for rehearing of that Court's decisions filed on June 22, 1978 denying petitions for writs of review of Decision Nos. 86794 and 87828 of the Public Utilities Commission of the State of California entered in the above-captioned proceedings.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph (2).

DATED: October 16, 1978.

JOHN R. BURY
WILLIAM E. MARX
ROLLIN E. WOODBURY

By /s/ Rollin E. Woodbury
Attorneys for
Southern California Edison Company

(Certificate of Service omitted in printing)

APPENDIX 4.

Notice of Appeal to the Supreme Court of the United States (Filed October 16, 1978).

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner,

vs.

Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23605.

Southern California Edison Company, Petitioner,

vs.

Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Claire T. Dedrick, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23723.

TO THE RESPONDENTS, PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, being at the relevant times the members of said Public Utilities Commission, AND TO JANICE E. KERR, HECTOR ANNINOS and TIMOTHY E. TREACY, THEIR ATTORNEYS:

NOTICE IS HEREBY GIVEN that the above-named petitioner, Southern California Edison Company, hereby appeals to the United States Supreme Court from the final judgments of the Supreme Court of the State of California entered in the aforesaid two integrally related cases entitled *Southern California Edison Company v. Public Utilities Commission, et al.* (S.F. Numbers 23605 and 23723) on July 19, 1978, denying a petition for rehearing of that Court's decisions filed June 22, 1978, denying petitions or writs of review of Decision Nos. 86794 and 87828 of the Public Utilities Commission of the State of California.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph (2).

DATED: October 16, 1978.

JOHN R. BURY
WILLIAM E. MARX
ROLLIN E. WOODBURY

By /s/ Rollin E. Woodbury
Attorneys for Petitioner
Southern California Edison Company

APPENDIX 5.

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

PETITION OF SOUTHERN CALIFORNIA EDISON COMPANY FOR REHEARING OF DECISION NO. 86794 OR FOR RECONSIDERATION AND MODIFICATION THEREOF

Pursuant to Section 1731 of the Public Utilities Code, Southern California Edison Company ("Edison") respectfully petitions the Commission for rehearing or reconsideration and modification of its Decision No. 86794 (the "Decision") upon each and all of the grounds hereinafter set forth, with respect to which Edison respectfully submits that the Commission has erred.

A. With regard to rate of return:

1. At the outset of the Decision,[1] the Commission misapplied the United States Supreme Court decisions of *Federal Power Commission, et al., v. Hope Natural Gas Company* (1944) 320 U.S. 591, 605, and *Bluefield Waterworks and Improvement Company v. West Virginia Public Service Commission,* 262 U.S. 679, 692-3, as defining the revenue requirement, which should be allowed by a regulatory commission, as the minimum amount which will enable the Com-

[1]Decision, p. 7.

pany to operate successfully, to maintain its financial integrity and to compensate its investors for risks assumed. What should be allowed and what is the minimum necessary to avoid confiscation are not the same concepts.[1]

2. In purporting to allow a rate of return which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison,"[2] the Commission made no adjustment therein to allow for the fact that the Decision would not be effective until *after* the end of the test year; the result is an obvious inability, under such circumstances, due to earnings attrition as a result of inflation, for the Company to earn the rate of return the Commission deemed to be the *minimum* required.[3] It should be readily apparent that the "return" which the Commission finds to be the "minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" cannot be earned utilizing rates, based upon such rate of return, which will not be effective until some time after the end of the test period. Furthermore, the continued increases in the cost of senior capital,

[1]*Eg., Southern California Edison Co.,* Appl. No. 52336, Decision No. 78802, issued June 15, 1971, 72 CPUC 282, 289; *Pacific Telephone and Telegraph Co. v. PUC,* 34 Cal.2d 822, 829 (1950); *Banton v. Belt Line Ry. Corp.,* 268 U.S. 413, 422-4 (1925).

[2]Decision, p. 23.

[3]Note dissenting opinions of Commissioners Sturgeon and Symons. *C.F., New England Telephone and Telegraph Co. v. Dept. of Public Utilities,* (Supreme Judicial Court of Massachusetts) 354 N.E.2d 860 (1976).

resulting from additional issues thereof after the test year at costs above the imbedded costs of such senior capital can only serve to aggravate in the future the deficiency in the earned return below that "authorized" by the Commission as the *minimum* required.

3. The rate of return allowance, based on a return on equity of 12.63% cannot reasonably be expected to produce a market price for Edison's common stock which will permit the issuance of new common shares, given the cost of issuing and market pressures resulting from such issuance, without resulting in a dilution of book value per share. Inability to attract such new equity capital without so impairing the integrity of the existing investor's investment cannot reasonably be said to meet the *Hope* and *Bluefield* tests and amounts to confiscation.

4. In fixing such *minimum* rate of return, the Commission made a downward adjustment because of its determination that Edison's election to ratably flow-through ("normalize") the increased investment tax credit (ITC) available under the Tax Reduction Act of 1975 reduced Edison's risk. But the Commission ignored completely and made no adjustments in rate of return for the *added* risks to Edison resulting from the actions thereafter taken in its Decision.

B. With regard to rate basė:

1. In rejecting Edison's proposal for the inclusion of substantial nonoperative construction work in progress (NOCWIP) in rate base, to increase

coverages and needed cash flow,[1] the Commission referred to its decision in the PG&E case (Application No. 55509, Decision No. 86281) where it suggested possible alternatives, "especially one that would expedite the inclusion in rate base of plant as it comes on line."[2] However, having recited that principle as a basis for rejecting Edison's proposal to include NOCWIP in rate base, it proceeded to reject Edison's proposal to include $66 million in plants designated "Special Items—Nonweighted" which represent investment in plant for environmental purposes or replacement plant.[3] This plant, which does not contribute to increased capacity of the system and, therefore, is not associated with increased load or sales and revenues, was, according to the uncontradicted record, to be in service as of the end of the test year.[4] Rather than require Edison to file a new and separate application as would appear to be contemplated by the Commission's suggestion referred to in the PG&E decision,[5] Edison submits that it would be more appropriate to reflect the revenue requirements associated with such plant in the base rate increase authorized by Decision No. 86794 herein, particularly in view of the fact that the additional base rate adjustment authorized by the Decision will not be effective until after the end of the test year.

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[1]Decision, p. 76.

[2]*Ibid.*

[3]*Ibid.*, p. 79.

[4]Chubb, Tr. 3053-3056.

[5]Decision, p. 76.

Hardly a better or more appropriate opportunity to "expedite the inclusion in rate base of plant as it comes on line" could be imagined than such inclusion in rate base of the "Special Items—Nonweighted."

2. With respect to the Commission's rejection of Edison's proposal to include $400 million of NOCWIP in rate base on the grounds that the Commission rejected a similar proposal by PG&E, the Commission stated "We are not persuaded that Edison's financial position is so different from PG&E's that we should arrive at a different result."[1] As distinguished from the recent PG&E situation,[2] however, the uncontradicted record in this case indicates that Edison's net earnings in 1977 and 1978 if it were to earn the return contemplated by the Decision, would consist of approximately 40 to 50 percent allowance for funds used during construction (ADC).[3] In this connection, simple analysis demonstrates that the inclusion of NOCWIP in rate base produces $1 of increased cash flow for approximately each $1.50 increase in revenue requirements when the income tax effect of debt interest is considered,[1] rather than the more than $2 increase in revenue requirement which the Commission concludes is required.[2]

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[1]Decision, p. 76.

[2]The record indicates that PG&E's ADC as a percent of net income was in the range of 18%-22% in the period 1972-74. (See Ex. 58, Table A, page 2.)

[3]See Edison Reply Brief, p. 31 and Ex. 59.

[1]See Edison Opening Brief, p. 33.

[2]Decision, p. 76.

C. With regard to expenses:

1. Despite the absence of any testimony that the expenditures were not prudent when undertaken and in the face of uncontradicted testimony as to the reasons (reflecting ratepayer benefits[3]) for the abandonment of the project, the Decision improperly disallowed an after-tax write-off of $865,000 in the test year for abandonment of the Vidal Nuclear Generating Station Project[4] based on a 5-year amortization of the total project costs written off. Any such disallowance on grounds of an imprudent abandonment or any other grounds is unsupported by the record. Disallowance of such costs improperly and unlawfully denies the utility the recovery through rates of expenditures reasonably incurred by the Company in its continuing effort to maintain adequate utility service.

2. After adopting estimates for administrative and general ("A&G") expense for the test year based on an analysis of the Company's and Staff's estimates by A&G accounts,[5] the Decision makes a lump sum downward adjustment of $2,050,000 to the total A&G expense estimate so adopted for the test year which it characterizes as an "Adjustment to Public Relations Expense." The explanation of the estimates adopted by the Decision indicates that the "Public Relations Expense Adjustment" applies only to Accounts 920 and 921.[1] The basis for the

[3]Scofield, Ex. 123.

[4]Decision, p. 60.

[5]See Decision, p. 53a.

[1]*Ibid.*, p. 55.

Commission's adjustment appears to be summarized in the statement:

> "Administrative and general expenses include public relations expenses which have been heretofore discussed. In the absence of complete justification by Edison of all such expenses we have allocated $750,000 of a total of $2,800,000 for public relations for conservation, customer services, and other allowable expenses. The adjustment to administrative and general expenses as a result of this allocation is $2,050,000. In the future the conservation expenses contained in A&G should be budgeted separately under conservation."[2]

The "previous discussion" of public relations expense referred to in the quotation consisted of a reference to the TURN witness' testimony that essentially all public relations expense should be disallowed because "such activities are self-serving and image-building and are, therefore, an inappropriate burden to be thrust upon Edison's customers."[3] Such general testimony, which completely ignores the fact of commercial life that business enterprises, particularly utilities, whether public or private, *must* incur such expenses to maintain good relations with the public, can hardly be considered substantial evidence.

The Commission also refers to its discussion of the subject of public relations expenses in

[2]*Ibid.*, p. 54.

[3]*Ibid.*, p. 50.

PG&E Decision No. 84902 including the Commission's admonition in that decision "that all public relations expenses should be described and justified *in detail* by utilities and *their appropriateness verified by our staff* in all future rate proceedings." (Last emphasis added.)

It will be noted from the tabulation of A&G expense estimates at page 53a of the Decision that the Commission Staff has verified as appropriate $33,481,000 in expenses in Account 920 and $8,202,000 in Account 921. The Commission adopted estimates recognize the appropriateness of a higher level of expenses for these accounts, higher by $1,022,000 total for Accounts 920 and 921. However, in applying its downward adjustment of $2,050,000 for disallowance of public relations expense the Commission adopted expense estimates for Accounts 920 and 921 are *below* the level *verified as appropriate by staff* a total of $1,028,000 for the two accounts.

Thus, not only has the Commission made an adjustment for public relations expense not supported by substantial evidence in this record, it has drastically departed from the criteria of the earlier PG&E decision which it purports to be following.

A compounding factor is with respect to the credit to AG&G expense adopted by the Commission in Account 922 representing amounts transferred from expense to construction costs.[1] The Commission has based its credit estimate adopted in Account 922 on the total estimate

[1]*Ibid.*, p. 56.

(before "public relations expense adjustment") adopted for Accounts 920 and 921. However, if the public relations expense adjustment was appropriate (which we do not believe to be shown to be the case on this record), a portion of it should obviously be reflected in the credit in Account 922. Yet the tabulation on page 53a of the Decision shows that the Commission's adopted credit in Account 922 is $351,000 *more* than the Staff's adopted estimate of this credit while, with the Commission's $2,050,000 downward adjustment in Accounts 920 and 921, the total net estimate adopted by the Commission for these two accounts is $1,028,000 *less* than the Staff's estimate. Clearly, even if the Commission's public relations expense adjustment were justified (which we do not believe to be the case), it has failed to properly reflect its effect in its adopted credit estimate in Account 922.

3. In a number of instances, the Commission, when faced with the inability to choose between a number of expense estimates, determined to average the two estimates, or appeared to split the difference. In early every case, where there was a difference in operating expense estimated by the Company and the Staff of the Commission, the Commission adopted estimates lower than those supported by the Company witness. Such actions become of particular significance in this Decision because of the circumstances previously noted that the Commission's authorized rate of return was that which the Commission found to be the *minimum* needed to attract

capital and not impair the credit of Edison. Under these circumstances, aside from the problem of regulatory lag, it is apparent that to the extent the Commission's adoption in the Decision of estimates of expenses prove to be *too* low, the Commmission authorized ***minimum*** return cannot be expected to be realized, and the result in such case can only be unlawful confiscation.[1]

D. With regard to cost allocation and rate design:

The Decision, in discussing cost allocation methods,[1] clearly adopts the monthly peak responsibility (MPR) method used by Edison and the Commission Staff for jurisdictional separation as the preferred method for that purpose.[2] As to the allocation of costs among customer groups, the method adopted by the Commission for purposes of this Decision is not so clear. Edison had pointed out in its brief[3] that its use of the load factor-diversity factor method for allocation of costs among California jurisdictional customer groups represented the middle ground between the extremes of positions urged by other parties on this issue and produces a reasonable result. Edison interprets the Commission's comment that the MPR method "should be extended for California jurisdictional operations in the manner recommend-

[1]See 320 U.S. 591, 605, *supra*; 262 U.S. 679, 692-3, *supra; Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926); *New England Telephone and Telegraph Co. v. Dept. of Public Utilities, supra*, p. 2.

[1]Decision, pp. 89, *et seq.*

[2]*Ibid.*, p. 92.

[3]See Edison Opening Brief, pp. 97-8.

ed by our staff"[4] as indicating a preference for that method for cost allocation among California jurisdictional customer groups when sufficient data has been developed to permit such procedure to be applied and reasonably reliable results obtained. This seems implicit in the paragraph of the Decision following the quoted language.

As Edison stated in its brief,[1] it has no axe to grind as far as cost allocation is concerned so long as the method or methods used permits it to recover its total costs. We believe, however, there is unassailable wisdom in Commissioner Symons' dissent suggesting that the soundest and fairest cost allocation and rate design is that which produces rates where each class pulls its own weight as to costs.

E. Miscellany:

1. Edison urges that, in addition to others discussed above, Commission determinations reflected in Findings Nos. 5g., 5i., 5j., 5k., and 5l. are unsound and not supported by substantial evidence of record and are arbitrary and unlawful.

2. In the light of the critical nature of any deficiencies in revenue or excess of expense over those adopted in the Decision because of Edison's being allowed only a minimum rate of return, Edison respectfully urges that, if the Commission were to review and reconsider the record as to revenue and expense estimates in the light of the conservation expenditures ap-

[4]Decision, p. 92.

[1]Edison Opening Brief, p. 98.

proved, the reasonableness of Edison's estimates would become apparent, particularly in view of the decision issuing near the end of the test year.

WHEREFORE, Edison, for the reasons set forth above, prays for rehearing of the Commission's Decision No. 86794 or for reconsideration and modification thereof.

Respectfully submitted,
ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
/s/ By William E. Marx
Attorneys for Petitioner
Southern California Edison Company

Dated: January 7, 1977

VERIFICATION

I, E. A. MYERS, JR., am an officer, to wit, a Vice President, of Southern California Edison Company, the Petitioner herein, and am authorized to make this verification on its behalf. The foregoing Petition of Southern California Edison Company for Rehearing of Decision No. 86794 or for Reconsideration and Modification Thereof is true of my own knowledge, except as to those matters which are therein stated on information and belief, and as to those matters I believe them to be true, and that I make this verification for and on behalf of said Petitioner as such officer.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on January 7, 1977, at Rosemead, California.

/s/ Edward A. Myers, Jr.

CERTIFICATE OF SERVICE

I hereby certify that I have this day arranged to have served by mail the foregoing Petition of Southern California Edison Company for Rehearing of Decision No. 86794 or for Reconsideration and Modification Thereof upon all appearances herein pursuant to the Commission's Rules of Practice and Procedure.

I declare under penalty of perjury that the foregoing is true and correct.

Dated at Rosemead, California, this 7th day of January, 1977.

/s/ William E. Marx
Attorney for Petitioner
Southern California Edison Company

APPENDIX 5a.

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY for authority to increase rates charged by it for electric service. Application No. 54946, Filed June 7, 1974.

PETITION OF SOUTHERN CALIFORNIA EDISON COMPANY FOR REHEARING AND RECONSIDERATION OF DECISION NOS. 86794 and 86986 AND FOR REOPENING OF RECORD TO TAKE ADDITIONAL EVIDENCE

Southern California Edison Company ("Edison"), the Applicant herein, hereby petitions the Commission to rehear and reconsider Decision Nos. 86794 and 86986 and to reopen the record for further opportunity to be heard in the light of subsequent development, as hereinafter set forth, on issues relating to the Commission's treatment of investment tax credit ("ITC") and rate of return in Decision No. 86794.

Decision No. 85294, issued December 30, 1975, authorized a partial general increase herein based on estimates of sales, expense and rate base sponsored by the Commission Staff. Decision No. 86794, issued December 21, 1976, determined the balance of the request for rate relief in this application. In Decision No. 86794 the Commission, among other things, while adopting Edison's proposal for ratable flow-through of

the increased ITC benefits under the Tax Reduction Act of 1975, indicated that its determination of rate of return for purposes of fixing rates therein included "consideration of the election of Opinion 2, ratable flow-through, for additional investment tax credit allowances permitted by the Tax Reduction Act of 1975"[1] on the basis that election of Option 2 "reduces external financing requirements and thereby reduces investor risk."[2]

Edison, in view of such determination by the Commission, and the provisions of Section 46(f) of the Internal Revenue Code indicating that the increased ITC benefits under the Tax Reduction Act of 1975 would be denied to utilities when the benefits thereof, when Option 2 was elected, were faster than ratably flowed-through to the ratepayer, sought the advice of independent outside legal counsel with special expertise in this area, as to whether the availability of the ITC to Edison was jeopardized by the Commission's treatment of the ITC issue in Decision No. 86794. Such independent legal counsel, after careful and comprehensive review of the decision and of the applicable tax laws, have concluded that the Commission's treatment of ITC in Decision No. 86794 will seriously jeopardize Edison's ability to avail itself of those increased ITC benefits for all open tax years as well as for the future.

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[1]Decision No. 86794, Finding No. 3, p. 103.

[2]*Ibid.*, Finding No. 5i, p. 105.

In addition, Arthur Andersen & Co., Edison's independent auditors, became separately concerned as to the effect of the Commission's actions in this regard upon Edison's ability to avail itself of the increased ITC benefits and concluded that the exposure to such adverse consequence should be reflected in a footnote to Edison's financial statements.

The loss of such benefits, if reflected in Edison's cost of service for ratemaking purposes, would have serious impact on the Company's California ratepayers in the years ahead amounting to tens of millions of dollars. The alternative would, of course, involve substantial impact on the Company which could cause serious deterioration in its financial position and jeopardize its Aa bond rating.

Edison believes that the Commission did not intend by any of its actions to deprive California ratepayers of the increased benefits of ITC nor to impose any such additional burdens on the ratepayer nor to increase risk of loss of Edison's Aa bond rating, which itself would result in higher costs to the ratepayer for future service, and deny Edison benefits of increased cash flow and interest coverage at a time when its needs for investment capital are at an all time high. Edison, therefore, seeks rehearing and/or reconsideration and modification of Decision No. 86794 so as to eliminate such jeopardy to Edison's ability to realize the increased ITC benefits under the Tax Reduction Act of 1975, as extended by the Tax Reform Act of 1976.

Wherefore, Edison respectfully requests the Commission to grant this petition, made pursuant to the provisions of the Public Utilities Code (e.g., 1973, 1736 and 1708), and, after full opportunity to be heard,

reconsider Decision No. 86794 in those respects and make modifications thereto which would eliminate any jeopardy to Edison's ability to realize such increased ITC benefits.

Respectfully submitted,

ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
By /s/ William E. Marx
Attorneys for
Southern California Edison Company

Dated: February 18, 1977

VERIFICATION

I, EDWARD A. MYERS, JR., am an officer, to wit, a Vice President, of Southern California Edison Company, the Petitioner herein, and am authorized to make this verification on its behalf. The foregoing Petition of Southern California Edison Company is true of my own knowledge, except as to those matters which are therein stated on information and belief, and as to those matters I believe them to be true, and that I make this verification for and on behalf of said Petitioner as such officer.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on February 18, 1977, at Rosemead, California.

/s/ Edward A. Myers, Jr.

CERTIFICATE OF SERVICE

I hereby certify that I have this day arranged to have served by mail the foregoing Petition of Southern California Edison Company upon all appearances herein pursuant to the Commission's Rules of Practice and Procedure.

I declare under penalty of perjury that the foregoing is true and correct.

Dated at Rosemead, California, this 22nd day of February, 1977.

/s/ William E. Marx
Attorney for Petitioner
Southern California Edison Company

APPENDIX 5b.

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

APPLICATION FOR REHEARING OF SOUTHERN CALIFORNIA EDISON COMPANY OF DECISION NO. 87828 (PURSUANT TO PUBLIC UTILITIES CODE SECTION 1731)

Pursuant to Section 1731 of the Public Utilities Code, Southern California Edison Company ("Edison"), to preserve its legal rights and remedies, respectfully petitions the Commission for rehearing of its Decision No. 87828 ("the Decision") upon each and all of the grounds hereinafter set forth.

I
Background

As outlined in the Decision, Edison, on January 7, 1977, petitioned for rehearing or for reconsideration and modification of the Commission's Decision No. 86794, dated December 21, 1976, which had authorized a general increase in Edison's rates. By its Decision No. 86986, dated February 15, 1977, the Commission denied Edison's petition for rehearing, with one exception; it did grant a rehearing limited to the issue of the manner in which certain items of replacement plant and plant installed by end of the year 1976 to meet environmental requirements should be included

in rate base.[1] Its denial applied, among other things, to the issues raised by Edison in its petition for rehearing concerning Finding No. 5i in Decision No. 86794, relating to Edison's selection of Option 2 for the increase in investment tax credit ("ITC") allowances provided for under the Tax Reduction Act of 1975 ("TRA").

Thereafter, on February 22, 1977, Edison filed a petition for rehearing and reconsideration and for reopening of the record in Decisions Nos. 86794 and 86986 (denying rehearing), requesting, among other things, reopening of the record to take additional evidence upon the ITC issue. By its Decision No. 87088, dated March 15, 1977, the Commission denied the said petition for rehearing and for reconsideration, but, pursuant to Section 1708 of the Public Utilities Code, granted the petition to reopen the proceedings to take additional evidence relating to the ITC and rate of return issues.

Consolidated public hearings were held on both the rate base items, for which rehearing had been granted, and upon the ITC and rate of return items, for which the record had been reopened. After submission on receipt of concurrent opening and closing briefs, the Commission rendered Decision No. 87828. Thus, the present posture of the case involves a decision relating to both a rehearing and a reopening (cf., *City of Los Angeles v. PUC,* 15 C.3d 680, 706).

A petition, dated March 11, 1977, for writ of review of Decision No. 86794 was filed by Edison with the Supreme Court of the State of California (No. S.F. 23605).

[1]Designated "Special Items—Nonweighted".

In the light of the provisions of the California Public Utilities Code and particularly Sections 1731 and 1708, Edison files this application for rehearing in order to preserve its legal rights and remedies.

II

Specification of Grounds For Application for Rehearing

As heretofore indicated to the Commission,[1] Edison believes that the Commission did not intend by any of its actions to deprive California ratepayers of the increased benefits of ITC nor to deny Edison the benefits of increased cash flow and interest coverage resulting therefrom; Edison submits that Decision No. 87828 fully confirms the accuracy of its belief in this regard. However, Edison respectfully applies for rehearing of Decision No. 87828, on each of the following grounds:

A. While recognizing that Internal Revenue Service ("IRS") information letters are provided in the interest of sound tax administration in answer to inquiries and that such letters purport to call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts,[1] the Commission in this Decision distinguishes the application of such principles involved in the information letters to the Department of Public Utilities, City of Dallas, Texas (Exhibit No. 126), and to the Public Service Commission of New Mexico (Exhibit No. 127) from the case at bar, and its

[1]Exh. 130, p. 2 (Mr. Reenders' testimony); see also Petition for Reopening, dated February 18, 1977, p. 3.

[1]Decision No. 87828, p. 13.

Findings 5 and 7 and Conclusion 2 are based upon such distinctions. Thus, Findings 5 and 7 and Conclusion 2 in the Decision are predicated upon recognition by the IRS of the efficacy, under the federal tax laws, of the distinctions set forth and relied upon in the Decision between the *Dallas* and *New Mexico* tax principles and the case at hand. There is no substantial evidence in the record to establish that the IRS had theretofore, or could be predicted to, recognize the appropriateness of such distinctions under the federal tax laws; nor were any authorities supportive of such distinctions referred to in the Decision. While it can be recognized that we are here dealing with new amendments to the federal income tax laws, with final regulations not yet issued and with a question involving their applicability to a factual set of circumstances that has apparently not yet been ruled upon,[1] the fact is that the record does not contain substantial evidence to support the aforesaid findings and conclusions in the Decision.[2]

Based on such distinctions, we believe said findings and conclusions support a favorable IRS ruling and are seeking a favorable ruling from the IRS. If the IRS issues a ruling which recognizes such distinctions, this problem will, of course, be resolved, but, absent a favorable ruling by the IRS, the jeopardy to Edison and

[1]It is for this reason that Edison urges the cooperation of the Commission in seeking a prompt revenue ruling. See Section III, *infra*, p. 7.

[2]There was testimony in the record upon the basis of which the IRS could appropriately reach the same result, from a different standpoint: cf., Reenders' testimony, Tr. 9212-14.

its consumer ratepayers of loss of eligibility for the additional ITC benefits, as reflected in Edison's petition which resulted in the reopened hearings and in the discussions in the Decision,[3] is not eliminated.

B. The Commission's determinations in Decision No. 87828 reflected in Finding 8 and Conclusion 3 are not supported by substantial evidence and are unlawful.

1. The Commission refused in Decision No. 87828 to include in rate base plant items which the uncontroverted record showed do not contribute to increased capacity of the system, and therefore are not, when operational, associated with increased load or sales.[1] Because such plant became operational before the rate increases authorized by the Decision were to be effective,[2] and the allowance for funds on such investment terminated prior to such rate increases becoming effective,[3] the Commission's action unreasonably and erroneously denies the utility an opportunity to earn upon such plant devoted to a public use and thus to recover its cost of invested funds for an extended period in the absence of other expedited rate relief.

2. The Commission's observation in the Decision[4] that "treating this plant as request-

[3]Decision No. 87828, pp. 5 and 6.

[1]Exh. 33, p. 2.

[2]*Ibid.*

[3]*Ibid.*, p. 4.

[4]Decision No. 87828, p. 17.

ed by Edison would result in its inclusion in both the ADC base and rate base for a portion of the year to the detriment of the ratepayer" erroneously suggests a duplication in the recovery by Edison of such costs would result under Edison's proposal and is contrary to the evidence in the record.[1]

3. The refusal to apply the principle indicated in *Pacific Gas and Electric Company* Decision No. 86281 to determine such rate base issue in this case, as urged by Edison, apparently upon the sole basis that there was more money involved in the PG&E situation,[2] is unreasonable and arbitrary and therefore unlawful.

III
Securing IRS Ruling

In view of the commonality of the interests of the Commission, Edison and its consumer ratepayers and employees in preserving the benefits of the additional ITC provided by the TRA, and because of the desirability, on behalf of all such interests, to determine definitively the existence or nonexistence of any differences of views or positions, as between the Commission and the IRS, concerning the effect of the actions taken by the Commission upon Edison's eligibility for the additional investment tax credit, Edison respectfully urges the cooperation of the Commission in seeking a prompt revenue ruling from the Internal Revenue Service for

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[1]See Chubb Exh. 133, pp. 2 and 4: see also Edison's Opening Brief in reopened proceeding, pp. 33-38.

[2]Decision No. 87828, pp. 17-18.

its confirmation of the findings and conclusions of the Commission as set forth in Decision No. 87828 (Findings Nos. 2, 3, 5 and 7 and Conclusion No. 2). Edison respectfully submits that the Commission's cooperation and assistance in Edison's efforts to obtain such definitive revenue ruling prior to the rulings in connection with this application becoming final determinations, could retain for the Commission the greatest latitude for it to consider and, if deemed desirable by it, to take any further appropriate action, should any such differences develop (cf., *City of Los Angeles v. PUC*, 15 C.3d 680, 706).

WHEREFORE, Edison, for the reasons set forth above, applies for rehearing of the Commission's Decision No. 87828.

Respectfully submitted,
ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
/s/ By Rollin E. Woodbury
Attorneys for
Southern California Edison Company

DATED: September 26, 1977.

VERIFICATION

I, EDWARD A. MYERS, JR., am an officer, to wit, a Vice President, of Southern California Edison Company, the Applicant herein, and am authorized to make this verification on its behalf. The foregoing Application for Rehearing of Southern California Edison Company is true of my own knowledge, except as to those matters which are therein stated on informa-

tion and belief, and as to those matters I believe them to be true, and that I make this verification for and on behalf of said Applicant as such officer.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on September 26, 1977, at Rosemead, California.

/s/ Edward A. Myers, Jr.

CERTIFICATE OF SERVICE

I hereby certify that I have this day arranged to have served by mail the foregoing Application for Rehearing of Southern California Edison Company upon all appearances herein pursuant to the Commission's Rules of Practice and Procedure.

I declare under penalty of perjury that the foregoing is true and correct.

Dated at Rosemead, California, this 26th day of September, 1977.

/s/ Rollin E. Woodbury
Attorney for Applicant
Southern California Edison Company

APPENDIX 6.

Decision No. 86986

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

ORDER GRANTING LIMITED REHEARING OF DECISION NO. 86794

The Commission has considered each and every allegation of the petition of Southern California Edison Company (Edison) for rehearing or modification of Decision No. 86794 (petition) and is of the opinion that good cause for limited rehearing of Decision No. 86794 has been shown. In light of Edison's petition we wish to reconsider our decision as to certain items of replacement plant and plant installed to meet environmental requirements, and have concluded that rehearing of Decision No. 86794 should be granted for this limited purpose. In all other respects Edison's petition should be denied. Therefore,

IT IS ORDERED that:

1. Rehearing is granted, limited to the issue of the manner in which certain items of replacement plant and plant installed by end of year 1976 to meet environmental requirements (denominated "Special Items—Nonweighted" in this proceeding) should be included in rate base.

2. Rehearing shall be held before such Commissioner and/or Examiner and at such time and place

as may be hereafter designated. The Executive Director is directed to cause appropriate notice of rehearing to be mailed at least ten (10) days before such rehearing.

3. Except to the extent granted in Ordering Paragraph No. 1, the petition of Southern California Edison Company for rehearing or modification of Decision No. 86794 is denied.

The effective date of this Order is the date hereof.

Dated at San Francisco, California, this 15th day of February, 1977.

/s/ ROBERT BATINOVICH
President
/s/ LEONARD ROSS
/s/ RICHARD D. GRAVELLE
Commissioners
Commissioner Vernon L. Sturgeon,
being necessarily absent, did
not participate in the disposition
of this proceeding.

I dissent. I would have granted total petition.

/s/ WILLIAM SYMONS, JR.

CERTIFIED AS A TRUE COPY

/s/ H. L. Farmer
Acting Executive Director
Public Utilities Commission
State of California

APPENDIX 6a.

Decision No. 87088

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54946, (Filed June 7, 1974).

ORDER GRANTING PETITION TO REOPEN THE RECORD AND TAKE ADDITIONAL EVIDENCE

Southern California Edison Company petitions the Commission to rehear and reconsider Decisions Nos. 86794 and 86986 and to reopen the record for further opportunity to be heard on the issues relating to the Commission's treatment of the investment tax credit and rate of return in Decision No. 86794. The petition to rehear and reconsider is denied on the ground that petitioner has previously petitioned for rehearing under Section 1731 of the Public Utilities Code and that petition was decided in Decision No. 86986.

However, based on the facts and argument set forth in the petition, the petition to reopen to take further evidence on the issues relating to the investment tax credit and rate of return is granted pursuant to Section 1708 of the Public Utilities Code. Such further hearing shall be at a time and place to be set.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 15th day of March, 1977.

ROBERT BATINOVICH
President
WILLIAM SYMONS, JR.
VERNON L. STURGEON
LEONARD ROSS
RICHARD D. GRAVELLE
Commissioners

CERTIFIED AS A TRUE COPY
/s/ H. L. Farmer
Acting Executive Director
Public Utilities Commission
State of California

APPENDIX 6b.

Decision No. 88022 OCT 18, 1977

Before the Public Utilities Commission of the State of California.

In the Matter of the Application of Southern California Edison Company for authority to increase rates charged by it for electric service. Application No. 54956, (Filed June 7, 1974).

ORDER DENYING REHEARING
OF DECISION NO. 87828

An application for rehearing of Decision No. 87828 having been filed by Southern California Edison Company, the Commission having considered this application and the allegations contained therein and being of the opinion that good cause for rehearing of Decision No. 87828 has not been made to appear;

IT IS ORDERED that rehearing of Decision No. 87828 is hereby denied.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 18th day of October, 1977.

/s/ ROBERT BATINOVICH
President
/s/ RICHARD D. GRAVELLE
/s/ CLAIRE T. DEDRICK
Commissioners

I would grant rehearing.

/s/ WILLIAM SYMONS, JR.
Commissioner
I abstain.
/s/ VERNON L. STURGEON
Commissoner
Certified as a True Copy
of the Original
/s/ H. L. Farmer
Asst. Executive Director, Public Utilities Commission
State of California

APPENDIX 7.

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. No. SF 23605.

PETITION FOR WRIT OF REVIEW OF PUBLIC UTILITIES COMMISSION DECISION NO. 86794, WITH POINTS AND AUTHORITIES IN SUPPORT THEREOF

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(213) 572-1931

March 11, 1977

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. No. SF 23605.

PETITION FOR WRIT OF REVIEW OF PUBLIC UTILITIES COMMISSION DECISION NO. 86794, WITH POINTS AND AUTHORITIES IN SUPPORT THEREOF

To the Honorable Mathew O. Tobriner, Acting Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Pursuant to Section 1756 of the Public Utilities Code, Southern California Edison Company ("Edison" or "petitioner") hereby petitions this Court to inquire into and determine the lawfulness of Decision No. 86794 (the "Decision") rendered by the Public Utilities Commission of the State of California ("Commission") on December 21, 1976. In rendering said Decision the Commission has exceeded its authority as conferred upon it by the Constitution and the laws of the State of California, it has failed to regularly pursue its authority as conferred by such Constitution and laws, and such Decision, if not corrected, will result in a taking of petitioner's property without the due process of law afforded by the Constitutions of the United States and of the State of California[1] and impose unnecessary burdens on Edison's ratepayer-consumers.

I
BACKGROUND OF PROCEEDINGS

The Decision of which petitioner seeks review resulted from the following proceedings:

1. On June 7, 1974, petitioner filed Application No. 54946 with the Commission requesting authority to increase its rates applicable to retail electric utility

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[1]United States Constitution Amendment XIV; California Constitution Article I, §7; *cf., Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926).

service in the State of California by an amount which would produce an estimated increase in revenues based upon test year 1976 of approximately $339 million.

2. On May 13, 1975, the Commission instituted an investigation regarding the investment credit provisions of the Tax Reduction Act of 1975[2] (on less than 10 days' notice because the utilities' election under the Act had to be made by June 26, 1975) and then on June 17, 1975, ordered the investigation discontinued because the Commission was not able to agree on a result.[3]

3. On June 25, 1975, petitioner elected Option No. 2, ratable[1] flow-through of the increase in ITC benefits under the Tax Reduction Act of 1975.[2] Such election was for the reasons disclosed in the evidence which Edison presented in Case No. 9915 and in conformity therewith.[3]

4. After full public hearings in connection with Application No. 54946, the Commission on December 21, 1976, issued Decision No. 86794 which (together with the partial general rate increase authorized December 30, 1975, by the Commission as an initial phase but not as final disposition of the matter—Decision No. 85294) authorized an aggregate increase in Edison's base rates amounting to approximately $122 million. In rendering Decision No. 86794 the Commission approved rates predicated upon estimates of sales and revenues, expenses, rate base and rate of return

[2]P.L. 94-12.

[3]Case No. 9915, Dec. No. 84568.

[1]Based on book life of plant which generated the credit (Section 46(f)(6), I.R.C.).

[2]Ex. 87, p. 1.

[3]Ex. 87, pp. 11, *et seq.*

adopted by the Commission for the test year 1976. The rate of return of 8.8% adopted by the Commission in fixing said rates reflects, according to Decision No. 86794, a downward adjustment which the Commission stated was in recognition of its asserted reduced risk resulting from petitioner's election to ratably flow-through ("normalize") the increase in investment tax credit ("ITC") benefits under the Tax Reduction Act of 1975.[4]

5. The hearing record in Application No. 54946 was devoid of any substantial evidence to support any such downward adjustment in rate of return based on alleged reduced risk resulting from petitioner's election to ratably flow-through ("normalize") the increase in ITC benefits under the Tax Reduction Act of 1975. Furthermore, Section 46(f)(2) of the Internal Revenue Code provides that such increase in ITC benefits may be denied a taxpayer electing ratable flow-through to ratepayers thereof if a regulatory commission flows-through such benefits to ratepayers faster than ratably for ratemaking purposes.

6. On January 7, 1977, Edison applied for rehearing on a number of issues including rate of return, rate base, certain expense items, sales and revenue levels, and the Commission's treatment of the increase in ITC allowances provided for in the Tax Reduction Act of 1975, contending, among other things, that the estimates adopted by the Commission, in fixing the level of rates in said Decision, including Finding No. 5i relating to rate of return, were unreasonable, unsound, arbitrary, not supported by substantial evidence of record, and were otherwise unlawful.

[4]Dec. No. 86794, p. 22, Findings 3 and 5i, pp. 103 and 105, respectively.

7. On February 15, 1977, the Commission issued Decision No. 86986 ordering limited rehearing of Decision No. 86794 on a rate base related issue not involved in this petition and denying rehearing on all other issues raised by petitioner in its petition for rehearing.[1]

II

SPECIFICATION OF ERRORS

The Commission committed reversible error in Decision No. 86794 in the following respects:

1. The Commission, in purporting to apply the principles laid down by the United States Supreme Court in *Federal Power Commission, et al., v. Hope Natural Gas Company* (1944) 320 U.S. 591, and *Bluefield Waterworks and Improvement Company v. West Virginia Public Service Commission* (1923) 262 U.S. 679,[2] adopted the 8.8% rate of return as the *minimum* amount required to enable Edison to operate successfully, to attract capital at reasonable cost and not impair its credit, and to compensate its investors for risks assumed.[3]

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[1]On February 21, 1977, Edison filed a further petition with the Commission seeking reopened hearings and calling the Commission's attention to the subsequent opinion of independent outside tax counsel as to the exposure to the loss of ITC benefits resulting from the Commission's action in this regard and the concern of its independent auditors relating thereto, on the assumption that it was not the Commission's intention to deprive California ratepayer-consumers of the increase in ITC benefits. The Commission's Staff has opposed such further petition on the grounds it was not timely and that the issue raised had been before the Commission and rejected.

[2]*Cf., Southern California Edison Co.* Application No. 52336, Decision No. 78802 issued June 15, 1971, 72 CPUC 282, 289; *Pacific Telephone and Telegraph Co. v. PUC,* 34 Cal. 2d 822, 829 (1950); *Banton v. Belt Line Ry. Corp.,* 268 U.S. 413, 422-4 (1925); *New England Tel. and Tel. v. Dept. of Pub. Utilities,* 354 N.E.2d 860, 868 (1976).

[3]Decision No. 86794, pp. 22-23.

2. In fixing such *minimum* required rate of return of 8.8%, the Commission made a downward adjustment because of its determination that Edison's election to ratably flow-through ("normalize") the increased ITC available under the Tax Reduction Act of 1975 reduced Edison's risk. This adjustment was not supported by substantial evidence in the rate proceeding.

Further, the Commission ignored completely and made no adjustments in rate of return for the added risks to Edison resulting from the actions otherwise taken in the Decision, including the exposure to the loss under Section 46(f)(2) of the Internal Revenue Code of the increase in ITC benefits afforded by the Tax Reduction Act of 1975, and the additional income tax liability for 1975 and 1976 which would result from such loss.

3. The adoption of a rate of return for ratemaking purposes, which the Commission determined to be the *minimum* required by Edison, has created a condition where, even if the rates authorized were to have been effective for the full test year (1976), any deficiency in sales and revenues or excess in expenses experienced in the test year, below or above the corresponding estimates adopted by the Commission, reduces the rate of return below the *minimum* the Commission found to be required and results in unlawful, confiscatory rates.

4. Furthermore, since the final adjustment of $44.4 million in base rates was not authorized until December 21, 1976, and did not become effective until after the 1976 test year, it is clear that petitioner could not possibly earn the authorized minimum rate of return and that the rates in effect during the test year were

confiscatory. In purporting to allow a rate of return which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison,"[1] the Commission made no adjustment therein to allow for the fact that the Decision would not be effective until *after* the end of the test year; the result is an obvious inability, under such circumstances, due to earnings attrition as a result of continuing inflation, for petitioner to earn the rate of return the Commission deemed to be the minimum required.[2] It is manifestly clear that the return which the Commission finds to be the "minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" cannot be earned utilizing rates, based upon such rate of return, which will not be effective until some time after the end of the test period 1976. Furthermore, the continued increases in the cost of senior capital, resulting from additional issues thereof after the test year at costs above the imbedded costs of such senior capital can only serve to aggravate in the future the deficiency in the earned return below that "authorized" by the Commission as the *minimum* required.

5. Petitioner has, since the Decision, been advised by experienced tax counsel that the Commission's treatment of ITC in Decision No. 86794 could be held violative of the requirements of Section 46(f)(2) of the Internal Revenue Code with the result that petitioner is exposed to losing the increase in ITC benefits for

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[1]Decision, p. 23.

[2]Note dissenting opinions of Commissioners Sturgeon and Symons to Decision No. 86794; *cf., New England Telephone and Telegraph Co. v. Dept. of Public Utilities*, (Supreme Judicial Court of Massachusetts) 354 N.E.2d 860 (1976).

1975 and 1976 afforded by the Tax Reduction Act of 1975.[1] The Commission assumed, in its Decision, in adopting the 8.8% rate of return as the minimum required by Edison, that such increase in ITC benefits would not be lost. Under such circumstances, further confiscation of petitioner's property will result if petitioner is required to make substantial additional tax payments to the Internal Revenue Service for the years 1975 and 1976 as a result of loss of such increase in ITC benefits because of the Commission's Decision in this case with no ability to recoup such amounts from its ratepayers for such years.[2] Such loss would result in irreparable harm to the utility. The Commission's assumption that its treatment of the increase in ITC benefits would not expose petitioner to the risk of loss of such benefits under Section 46(f)(2) of the Internal Revenue Code was not supported by any evidence in the rate proceeding.

6. The Commission's determinations on rate of return in Findings 3 and 5i of Decision No. 86794[1]

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[1]See comparable IRS ruling (T:C:E:A:3) submitted to the Court under date of November 22, 1976, in the pending case involving Southern California Gas Company, *Southern California Gas Company v. PUC*, S.F. 23495.

[2]Under California law, utilities, such as Edison, are not permitted to increase rates retroactively. Cal. Pub. Utilities Code Sect. 728. *Pacific Tel. & Tel. v. PUC*, 62 Cal.2d 634, 649, *et seq.* (1965). See also *City of Los Angeles v. PUC*, 15 Cal.3d 680, 705, *et seq.* (1975).

[1]Pages 103 and 105, respectively. Findings 3 and 5i read as follows:

3. The 12.63 percent return on common equity included in the computations deriving the above 8.8 percent rate of return is reasonable and includes consideration of the election of Option 2, ratable flow-through, for the additional investment tax credit allowances permitted by the Tax Reduction Act of 1975.

(This footnote is continued on next page)

indicating that the 12.63% return on equity used in arriving at the 8.8% rate of return adopted for fixing rates in said decision considered the reduced risk which the Commission asserted resulted from petitioner's election of Option No. 2 for the additional ITC allowances permitted by the Tax Reduction Act of 1975, are not supported by substantial evidence in the record below.

7. The rate of return "allowance," based on a return on equity of 12.63% cannot reasonably be expected to produce a market price for Edison's common stock which will permit the issuance of new common shares, given the cost of issuing and market pressures resulting from such issuance, without resulting in a dilution of book value per share. Inability to attract such new equity capital without so impairing the integrity of the existing investor's investment cannot reasonably be said to meet the *Hope* and *Bluefield* tests.[1]

WHEREFORE, petitioner prays:

1. That a writ of review issue out of this Court, addressed to respondent Commission, commanding and requiring it to certify to this Court, at a specified time and place, all of the records and proceedings in Application No. 54946; and that Decision No. 86794 be reviewed by this Court with respect to the issues raised herein;

5i. Edison's selection of Option 2, ratable flow-through, for the increased ITC allowances provided in the TRA of 1975 reduces external financing requirements and thereby reduces investor risk and should be included in our consideration of a proper rate of return.

[1]*Cf., New England Tel. and Tel. Co. v. Dept. of Public Utilities* (Supreme Judicial Court of Mass.), 354 N.E.2d 860 (1976).

2. That this petition and all of said records and proceedings be fully inquired into and considered by this Honorable Court and that thereupon it be ordered that the actions of the Commission reducing the authorized rate of return because of Edison's election under the Tax Reduction Act of 1975 be annulled and that the matter be remanded to the Commission for further proceedings and modifications of Decision No. 86794 so as to make it consistent with a correct application of the *Hope* and *Bluefield* decisions and with this Court's determinations herein; and

3. For such other, further and different relief as this Court may deem proper.

Respectfully submitted,

SOUTHERN CALIFORNIA EDISON COMPANY
ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
/s/ By William E. Marx
Attorneys for Petitioner

Dated: March 11, 1977

VERIFICATION

I, HOWARD P. ALLEN, declare and state that I am an Executive Vice President of Southern California Edison Company, petitioner in the above-entitled action, and that I make this declaration for and on behalf of said petitioner. I have read the foregoing Petition for Writ of Review of Public Utilities Commission Decision No. 86794, and hereby declare and state that the contents thereof are true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

DATED: March 11, 1977

/s/ Howard P. Allen
Howard P. Allen

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF PETITION FOR WRIT OF REVIEW

I
PRELIMINARY STATEMENT

A writ of review is sought by Southern California Edison Company ("Edison" or "petitioner") for those portions of Decision No. 86794 issued by the Public Utilities Commission of the State of California ("Commission") on December 21, 1976, which determined that Edison's rates should be fixed on the basis of a rate of return which reflected a reduction to take into account alleged reduced risk resulting from Edison's election of Option No. 2, ratable flow-through ("normalization"), with respect to the increase in investment tax credit ("ITC") available under the Tax Reduction Act of 1975. The 8.8% rate of return adopted by the Commission in said rate decision as the *minimum* required by Edison was stated by the Commission to take into consideration alleged reduced risk resulting from such election by Edison of Option No. 2 notwithstanding the provisions of Section 46(f)(2) of the Internal Revenue Code which would deny to any utility electing Option No. 2 the increase in ITC benefits under the Tax Reduction Act of 1975 if such increase in ITC benefits are faster than ratably flowed-through to ratepayers by a regulatory commission having jurisdiction over the utility's rates.

The record below on which Decision No. 86794 was based was devoid of substantial evidence that such election by Edison of said Option No. 2 would reduce Edison's risk and what the magnitude of such alleged reduction in risk, if any, would be. Instead, the Commission gave no consideration to the added risk of exposure to loss by Edison, pursuant to the terms of said Section 46(f)(2), of such increase in ITC benefits resulting from the Commission's treatment of said increase in ITC benefits in Decision No. 86794 nor of the impact on Edison and its ratepayer-consumers that would result in event of such loss.

It is Edison's position that the Commission's determination of rate of return for Edison for test year 1976 in fixing rates in Decision No. 86794 is not supported by the record in the following respects:

1. The record is devoid of substantial evidence that Edison's risk would be reduced as a result of Edison's election of Option No. 2;
2. That, if such reduction in risk were to be assumed, there is no evidence quantifying such reduction in risk in terms of reduction in rate of return appropriate for fixing Edison's rates;
3. While there is evidence in the record indicating that there is risk that Edison would be denied the increase in ITC under the Tax Reduction Act of 1975 if such benefits, for ratemaking purposes, are faster than ratably flowed-through to the ratepayer, the Commission's treatment of ITC in Decision No. 86794, including the Commission's authorization of the *minimum* rate of return it adopted pursuant to its patently inaccurate reading of the *Hope* and *Bluefield*

decisions,[1] gave no consideration to the added risk nor to the impact on Edison and its rate-payer-consumers from exposure to such loss.

4. By adopting, in Decision No. 86794, an inadequate rate of return for ratemaking purposes not supported by substantial evidence, and by failing to consider the increased risk to Edison resulting from its treatment of ITC in Decision No. 86794, the Commission has failed to regularly pursue its authority within the meaning of Section 1757 of the Public Utilities Code of the State of California and has denied Edison property rights without due process of law in violation of the constitutions of the United States and the State of California.[2]

5. The Commission's determination of the rate of return requirement for Edison in Decision No. 86794 cannot reasonably be expected to produce a market price for Edison's common stock which will permit the issuance of new common shares without resulting in dilution of book value per share and thus fails to meet even the minimum requirements of *Hope* and *Bluefield.*

II
BACKGROUND

The procedural background of this controversy leading to the instant proceedings is summarized in the petition for writ of review at pages 2-4, *supra.*

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[1]See citations, *supra,* petition, pp. 4-5.

[2]U. S. Const. Amend. XIV; Calif. Const. Art. I, §7. *Cf., Board of Public Utility Commissioners v. New York Telephone Co.* 271 U.S. 23 (1926).

III
THE COMMISSION'S DOWNWARD ADJUSTMENT IN RATE OF RETURN IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE OF RECORD OR BY REASON IN THE LIGHT OF COMMISSION ACTION IN OTHER RATE PROCEEDINGS INVOLVING COMPARABLE UTILITY OPERATIONS

In fixing the rate of return for ratemaking purposes in Decision No. 86794, the Commission indicated that it made a downward adjustment because of its determination that Edison's election to ratably flow-through ("normalize") the increase in ITC available under the Tax Reduction Act of 1975 reduced Edison's risk. The Commission, in so doing, made reference[1] to its recent decision involving Southern California Gas Company dealing with the same issue[1] in which it made reference to its earlier decision in *Pacific Gas & Electric Co.,* Appl. Nos. 55509 and 55510, Decision No. 86281 issued August 24, 1976. Although the Commission did not quantify its ITC adjustment in precise terms, it is indicated, by reference to the contrast in return on common equity allowed to Pacific Gas and Electric Company ("PG&E") in Decision No. 86281 based on the same test year (1976),[2] that the Commission evaluated the differential in risk in

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[1]Decision No. 86794, p. 22.

[1]See *Southern California Gas Co.,* Appl. No. 55345, Decision No. 86595 issued November 2, 1976, p. 96.

[2]PG&E did not opt for "normalization" of the increased ITC but flowed-through such increased ITC on a rolling 5-year average basis.

terms of a lesser "allowance" of return on common equity of at least 0.20%.[8]

With a common equity ratio of 36.42% adopted by the Commission for Edison, the effect of a reduction in return on common equity of 0.20% on rate of return would be about 0.07% which on a rate base approaching $4 billion amounts to a reduction in return of almost $3 million, assuming that the Commission's treatment of ITC would not bring into play Section 46(f)(2) of the Internal Revenue Code as amended by the Tax Reduction Act of 1975. Decision No. 86794 referred to no evidence of record which would support such a translation of asserted "reduced risk" into such a reduction in authorized return and Edison submits there is no record support therefor.

As a practical matter, if the reduction in rate of return "allowance" resulting from the Commission's determination of "reduced risk" attributable to Edison's election of ratable flow-through of the increase in ITC benefits under the Tax Reduction Act of 1975 approaches $3 million,[1] such downward adjustment in rate of return will, in all probability, eliminate even any theoretical basis for such conclusion of "reduced

[8]In Decision No. 86281 the Commission authorized PG&E a rate of return based on a 12.83% return on common equity as compared with an allowance of 12.63 for Edison in Decision No. 86794 below. PG&E as a combination electric and gas utility would, because of that factor, have less risk than Edison. Similarly, the lower common equity ratio (36.42%) adopted by the Commission for Edison in Decision No. 86794 (at p. 23), as compared with 37.03% adopted by the Commission for PG&E in Decision No. 86281 (at p. 23), indicates a lesser risk for PG&E becuase of that factor and thus a *lower* return on common equity than Edison.

[1]And the likelihood is that the effect on return would be greater although the record below is not enlightening of that fact.

risk." This follows because the loss in cash flow and interest coverage resulting from such adjustment in rate of return may more than offset the increase in cash flow and interest coverage resulting from ratable flow-through of the increase in ITC benefits in the test year 1976 as compared with the effect on cash flow and interest coverage had the 5-year rolling average flow-through of the increased ITC (including the original 4% and the additional 6%) used in the PG&E case been applied. Yet, Decision No. 86794 totally fails to analyze the problem in such meaningful terms.

Such an analysis would recognize that Edison immediately flows-through the 4% ITC to its ratepayers,[1] whereas PG&E flows-through such ITC benefits as well as the additional 6% ITC on a rolling average basis.[2] It is therefore likely that, if the Commission were to have made a comparative analysis of the interest coverage and cash flow benefits in test year 1976 for Edison using (1) PG&E's method of flowing-through all ITC on a 4- or 5-year rolling average basis versus (2) Edison's method of immediate flow-through of the 4% portion and ratable flow-through of the 6% increase under the Tax Reduction Act of 1975, it would have found that there would have been a greater cash flow and interest coverage effect using the PG&E method. Under such circumstances, there would be no basis for concluding that Edison enjoys any "reduced risk" under its overall ITC treatment as compared with the PG&E treatment nor that the reduction in rate of return should be made on that basis. Clearly, without such an analysis, no eviden-

[1]Reenders, Ex. 87, Ex. 88.

[2]See *e.g.*, Decision No. 84902, p. 92, where PG&E used and the Commission approved a 4-year moving average.

tiary basis in the record below for reaching such a conclusion exists. Edison, having had no notice during the hearing of the Commission's intention to make such an adjustment in the rate of return,[3] was deprived of the opportunity to make such a showing.[4]

IV

THE COMMISSION HAS TOTALLY IGNORED THE INCREASED RISK TO PETITIONER RESULTING FROM ITS TREATMENT OF ITC IN DECISION NO. 86794

The Commission's treatment of ITC in Decision No. 86794 jeopardizes Edison's ability to realize such increase in ITC *at all* under the Tax Reduction Act of 1975. Because of the significant tax exposure and in view of the conclusion in the comparable IRS tax ruling issued to Southern California Gas Company (T:C:E:A:3) in connection with Decision No. 85627 (Petition for Writ of Review granted in S.F. 23495), Edison sought a legal opinion from outside counsel with special expertise in tax matters. That opinion concludes that the Commission's treatment of ratable flow-through ("normalization") of ITC benefits for ratemaking purposes as a risk reducing factor may violate the proscriptions of the Tax Reduction Act of 1975 and thus jeopardizes Edison's ability to retain the in-

[3]The Staff of the Commission proposed flow-through of the increase in ITC benefits on a 5-year rolling average basis (see Joshi, Ex. 68, Table 14-B, Tr. 5961; Ex. 88, Tables 2 and 3) and a rate base reduction for any portion of such credit not flowed-through (Ex. 68, Table 18-A Supplement; Ex. 88, Table 2).

[4]The Commission, on June 17, 1975, ordered the discontinuance of its investigation (Case No. 9915) to determine how to treat the increase in ITC benefits under the Tax Reduction Act of 1975 because of inability to agree upon a result (Decision No. 84568).

crease in ITC benefits for 1975 and 1976 and beyond which resulted from the Tax Reduction Act of 1975. Section 46(f)(2) of the Internal Revenue Code provides for disallowance of the 6% increase (the increase from 4% to 10%) in ITC under the Tax Reduction Act of 1975, once the utility has elected Option No. 2, ratable flow-through of such increase in ITC benefits, should either of the following occur:

> "(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or
>
> "(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)."

Said outside counsel's opinion is that if the Internal Revenue Service should conclude that the reduction in rate of return allowance in Decision No. 86794 attributable to Edison's election of Option No. 2, ratable flow-through ("normalization") of the increase in ITC benefits afforded by the Tax Reduction Act of 1975, constitutes "more than ratable" flow-through of such increase in ITC benefits, the language quoted above in (A) could be invoked by the IRS to seek to disallow all of such increase in ITC benefits for the years 1975 and 1976 as well as later ITC benefits attributable to plant additions in 1975 and 1976. The Commission in Decision No. 86794 has totally ignored this signifi-

cant risk to Edison arising from the Commission's actions.

Inasmuch as the Decision of the Commission fixing Edison's rates assumed no such loss and without such tax benefits the increased cash flow and interest coverage, on the basis of which the Commission adopted the 8.8% rate of return as the minimum required, could obviously not be realized, the rates authorized would clearly be confiscatory.

V

THE COMMISSION'S RATE OF RETURN DETERMINATION FAILS TO MEET THE HOPE AND BLUEFIELD TEST

The lower limit of the reasonable range of return on common equity is that level which will produce a market to book ratio for the utility stock high enough to permit the utility to issue new common shares without producing the adverse dilutive effects on the common equity investor's investment which results when sale of new common shares is made with the new proceeds per share below book value notwithstanding the expenses involved in marketing the new issue and the market pressures that result from such new issue.[1] The *Hope* and *Bluefield* decisions of the United States Supreme Court have laid down the tests of adequacy of earnings allowance on common equity in the following terms:

1. Must be comparable to earnings on investments of similar risk,[2]

[1]The Supreme Judicial Court of Massachusetts has found this minimum ratio to be 1.2. See *New England Tel. and Tel. Co. v. Dept. of Public Utilities,* (1976) 354 N.E.2d 860, at 867.

[2]See, *e.g.,* 320 U.S. at 603.

2. Must be such as not to impair the credit of the utility,[3] and
3. Must enable the utility to attract new capital at reasonable cost.[4]

Rates fixed by a regulatory commission at a level which may be expected to produce a level of earnings such that the utility is forced to sell additional shares of common stock below book value, thus resulting in the dilution of the book value of existing shares, should not, we submit, reasonably be considered as meeting tests 2 and 3 above, whether or not test 1 is met. Thus, as has been determined by the Supreme Judicial Court of Massachusetts, for a utility (like Edison) whose common stock has been selling considerably below book value, a rate of return determination for fixing rates should be reasonably designed to restore the market price to something above book value, taking into account the expenses and market pressures of new issues, to meet the tests of *Hope* and *Bluefield.*[1] That the Commission's adoption of 12.63% return on common equity for purposes of determining the "minimum" rate of return it used in fixing rates below is grossly inadequate to increase the price of Edison's common stock to the level of book value is clearly indicated by the effect on market price of the partial general increase the Commission authorized by Decision No. 85294 on December 30, 1975, making revised rates effective December 31, 1975, based on a return on common equity of

[3]*Ibid.*

[4]*Ibid.*

[1]See also *New England Tel. and Tel. Co. v. Dept. of Public Utilities, supra,* p. 20, footnote 1.

12.25%.[2] Notwithstanding that action by the Commission, the market price of Edison's common stock throughout 1976 continued well below book value, never reaching as high as $24.00 per share although the book value per share as of December 31, 1973, was over $28.00.[3]

VI
CONCLUSION

In sum, the record below is devoid of substantial evidence to support the Commission's downward adjustment in rate of return attributable to Edison's election to ratably flow-through to ratepayers the increase in ITC benefits afforded by the Tax Reduction Act of 1975, and the Commission, in Decision No. 86794, has totally ignored important risks to Edison in making its rate of return determination for purposes of fixing rates.

It is respectfully submitted that this matter should be remanded to the Commission for further deliberations and modification of Decision No. 86794 consistent with the Court's determinations herein so as to avoid Edison's being denied its property without due process of law as a result of such failure by the Commission to regularly pursue its authority and Edison and its ratepayer-consumers being denied the substantial benefits in the form of increased ITC allowances under the Tax Reduction Act of 1975 and later enactments.

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[2]Decision No. 85294, p. 16.

[3]Ex. 2, Table 5-C, p. 5-4. Edison's Annual Report to Stockholders for the year 1975, p. 26, indicates a book value per share at year end 1975 of $31.13.

For the foregoing reasons, petitioner Southern California Edison Company respectfully requests that this Court issue a writ of review herein.

Respectfully submitted,

ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
By /s/ William E. Marx
Attorneys for Petitioner
Southern California Edison Company

Dated: March 11, 1977

APPENDIX 7a.

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Richard D. Gravelle, and Claire T. Dedrick, the members of and constituting said Public Utilities Commission, Respondents. No. SF 23723.

PETITION FOR WRIT OF REVIEW OF PUBLIC UTILITIES COMMISSION DECISION NO. 87828 WITH POINTS AND AUTHORITIES IN SUPPORT THEREOF

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November 15, 1977

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Richard D. Gravelle, and Claire T. Dedrick, the members of and constituting said Public Utilities Commission, Respondents. No. SF 23723.

PETITION FOR WRIT OF REVIEW OF PUBLIC UTILITIES COMMISSION DECISION NO. 87828 WITH POINTS AND AUTHORITIES IN SUPPORT THEREOF

To the Honorable Rose Elizabeth Bird, Chief Justice, and to Associate Justices of the Supreme Court of the State of California:

Pursuant to Section 1756 of the Public Utilities Code, Southern California Edison Company ("Edison" or "petitioner") hereby petitions this Court to inquire into and determine the lawfulness of Decision No. 87828 (the "Decision") rendered by the Public Utilities Commission of the State of California ("Commission") on September 7, 1977, in Application No. 54946 below. In rendering said Decision, the Commission has exceeded its authority as conferred upon it by the Constitution and the laws of the State of California, it has failed to regularly pursue its authority as conferred by such Constitution and laws, and such Decision is not supported by substantial evidence which, if not corrected, will result in the taking of petitioner's property without the due process of law afforded by the Constitutions of the United States and of the State of California, and will impose unnecessary burdens on Edison and upon its ratepayer-consumers.

I
BACKGROUND OF PROCEEDINGS

The Decision of which petitioner seeks review resulted from the following proceedings:

1. After Decision No. 86794 (which decision is presently the subject of a Petition for Writ of Review filed with the Supreme Court of the State of California

(No. S.F. 23605)) was issued,[1] the Commission held further hearings to receive evidence upon both the issue of the manner in which certain items of replacement plant and plant installed by end of the year 1976 to meet environmental requirements should be included in rate base (the limited issue upon which rehearing had been granted by the Commission of Decision No. 86794) and the issues relating to the investment tax credit ("ITC") and rate of return which the Commission had reopened the proceedings to hear pursuant to Section 1708 of the Public Utilities Code.

2. After six days of additional hearings on those issues, and filing of briefs, the Commission issued, on September 7, 1977, its Decision No. 87828 which, after clarifying what actions it had taken in Decision No. 86794 with regard to the derivation of the rate of return authorized by said decision (varying interpretations had been given to those portions of Decision No. 86794), affirmed the said Decision No. 86794, which is the subject of the earlier Petition for Writ of Review No. S.F. 23605 as to all issues determined therein. Thus, the present posture of the case and of Decision No. 87828 involves a decision relating to both a rehearing and a reopening; cf., *City of Los Angeles vs. PUC,* 15 C.3d 680, 706 (1975).

3. An application for rehearing of Decision No. 87828 was timely filed with the Commission raising the issues included herein, which application was denied by the Commission by its Decision No. 88002 on October 18, 1977. This Petition is brought within

[1]The background of the proceedings which culminated in said Decision No. 86794 is outlined in said Petition for Writ of Review No. S.F. 23605, excerpts of which are reproduced in Appendix I attached hereto.

30 days of said denial, as required by the Public Utilities Code Section 1756.

4. Because this Petition for Writ of Review of Decision No. 87828 involves both: (a) a rate base issue, as to which the Commission at the time of the filing of Petition No. S.F. 23605 had granted a limited rehearing and was thus not an issue involved in the Petition for Writ of Review No. S.F. 23605, and (b) in addition issues on ITC and rate of return which, because of its clarification of what the Commission had done in Decision No. 86794, is in part inextricably related to Decision No. 86794, petitioner files this Petition for Writ of Review to seek judicial review and to preserve its legal rights and remedies. Petitioner respectfully suggests that the Court may wish to consolidate argument regarding this Petition with that relating to the Petition heretofore filed and designated No. S.F. 23605.

II
SPECIFICATION OF ERRORS

The Commission committed reversible error in each of the following respects:

A. *Rate Base Items*

1. The Commission refused in Decision No. 87828 to include in rate base plant items[1] which the uncontroverted record showed do not contribute to increased capacity of the system, and therefore are not, when operational, associated with increased load or sales. Because such plant became operational before the rate increases authorized by the Decision were to be effective and

[1]Such plant items were designated "Special Items—Nonweighted."

the allowance for funds on such investment (ADC) terminated prior to such rate increases becoming effective, the Commission's action unreasonably and erroneously denies the utility an opportunity to earn upon such plant devoted to a public use and thus to recover its costs of invested funds for an extended period in the absence of other expedited rate relief. The exclusion of such items from rate base and the resulting prevention of any opportunity to earn upon such plant devoted to a public use violates petitioner's constitutional rights and is a denial of due process of law.

2. The Commission's observation in the Decision that "Treating this plant as requested by Edison would result in its inclusion in both ADC base and rate base for a portion of the year, to the detriment of the ratepayer" erroneously suggests a duplication in the recovery by Edison of such costs under Edison's proposal. This is directly contrary to the evidence in the record and is not supported by the record.

3. The refusal to apply the principle which the Commission itself enunciated in *Pacific Gas and Electric Company* Decision No. 86281 (apparently upon the sole basis that there was more money involved in the Pacific Gas and Electric Company situation) is arbitrary and unreasonably discriminatory, and denies petitioner and its shareholders equal protection under the law.

B. *ITC and Rate of Return Issues*

1. While recognizing that Internal Revenue Service ("IRS") information letters are provided in the interest of sound tax administration in

answer to inquiries and that such letters call attention to a well-established interpretation or a principle of tax law without applying it to a specific set of facts (Decision No. 87828, page 13), the Commission, in the Decision, did not apply, but rather distinguished, the application of such principles involved in the information letters to the Department of Public Utilities of the City of Dallas, Texas (Exhibit 126) and to the Public Service Commission of New Mexico (Exhibit 127),[1] and based its Findings 5 and 7 and Conclusion 2 in the Decision upon such asserted distinctions. Thus, Findings 5 and 7 and Conclusion 2 in the Decision are predicated upon recognition by the IRS of the efficacy, under federal tax laws, of the distinctions set forth and relied upon in the Decision, in the case at hand, from the Dallas and the New Mexico tax principles. There is no substantial evidence in the record to establish that the IRS had theretofore or could be predicted to recognize the appropriateness of such distinctions under the federal tax laws; nor were there any authorities supportive of such distinctions referred to in the Decision. The record does not contain any substantial evidence in support of Findings 5 and 7 and Conclusion 2 of the Decision. If, in response to the revenue ruling request which has been filed with the IRS by the petitioner, the IRS issues a favorable ruling which recognizes such distinctions, this particular issue involving the appropriate treatment of the unamortized investment tax credit would, of course,

[1]The principle enunciated in said information letters is that the unamortized investment credit should be treated as equity capital and allowed the same rate of return as that permitted on other shareholder contributed capital.

be resolved, but, so long as there has been no such favorable ruling by the IRS, the jeopardy to Edison and its consumer-ratepayers of loss of eligibility for the additional ITC benefits is not eliminated, yet the Commission's Decision assumed and was based upon continued eligibility. The exposure of such loss is substantial.[1]

2. Nothing in Decision No. 87828, which affirms Decision No. 86794, modifies, clarifies or corrects the actions of the Commission, in purporting to apply ratemaking principles laid down by the United States Supreme Court in *Federal Power Commission, et al., vs. Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Bluefield Waterworks and Improvement Company vs. West Virginia Public Service Commission*, 262 U.S. 679 (1923), which erroneously established a rate of return determination that could not be reasonably expected to restore the market price to something above book value, taking into account the expenses and market pressures of new issues. Such actions fail to meet the tests of *Hope* and *Bluefield;* cf., *New England Tel. & Tel. vs. Department of Public Utilities*, 354 N.E.2d 860 at 867 (1976). Such issues heretofore raised in the Petition for Writ of Review relating to said Decision No. 86794 (No. S.F. 23605) persist in the affirmance of said decision by Decision No. 87828.

WHEREFORE, petitioner prays:

1. That a writ of review issue out of this Court, addressed to respondent Commission, commanding and requiring it to certify to this Court, at a specified

[1]See footnote 2 *infra* p. 26.

time and place, all of the records and proceedings in Application No. 54946, including all of the records in the rehearing and reopened proceedings therein, and that Decision No. 87828 be reviewed by this Court with respect to the issues raised herein;

2. That this Petition and all of said records and proceedings be fully inquired into and considered by this Honorable Court, that the actions of the Commission excluding from rate base the "Special Items—Nonweighted" be annulled, and that the matter be remanded to the Commission for further deliberations and modifications of Decision No. 87828 consistent with the Court's determination herein upon the issues of ITC and rate of return, in order to avoid Edison and its ratepayer-consumers and employees being denied the benefits of the increased ITC allowances under the Tax Reduction Act of 1975 and later amendments; and

3. For such other, further and different relief as this Court may deem proper.

Respectfully submitted,

SOUTHERN CALIFORNIA EDISON COMPANY
ROLLIN E. WOODBURY
ROBERT J. CAHALL
WILLIAM E. MARX
DENNIS G. MONGE
By /s/ Rollin E. Woodbury
Attorneys for Petitioner

DATED: November 15, 1977

VERIFICATION

I, Edward A. Myers, Jr., declare and state that I am a Vice President of Southern California Edison Company, petitioner in the above-entitled action, and that I make this declaration for and on behalf of said petitioner. I have read the foregoing Petition for Writ of Review of Public Utilities Commission Decision No. 87828, and hereby declare and state that the contents thereof are true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

DATED: November 15, 1977.

/s/ Edward A. Myers, Jr.

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF PETITION FOR WRIT OF REVIEW

I

PRELIMINARY STATEMENT

A Writ of Review is sought by Southern California Edison Company ("Edison") for those portions of Decision No. 87828 issued by the Public Utilities Commission of the State of California ("Commission") on September 7, 1977, which:

(a) denied the inclusion in rate base of plant items[1] not otherwise included in the 1976 test year rate base which became operational prior to the effective date of the final rate increases authorized by Decision No. 86794 (which was after the end of the test year) and which do not contribute to increased capacity of the system

[1]Designated "Special Items—Nonweighted."

and therefore do not, when operational, enable Edison to serve increased load or make increased sales; and

(b) concluded, without the support of any substantial evidence in the record, that the federal income tax principle (i.e., that the unamortized investment credit should be treated as equity capital and allowed the same rate of return as that permitted on the other shareholder contributed capital) involved in the information letters to the Department of Public Utilities of the City of Dallas, Texas (Exhibit 126) and to the Public Service Commission of New Mexico (Exhibit 127) was inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure, and asserted as a basis for the Commission's findings and conclusions in this regard.

II

THE COMMISSION IMPROPERLY EXCLUDED FROM RATE BASE THE ITEMS DESIGNATED "SPECIAL ITEMS—NONWEIGHTED," DENYING EDISON AN OPPORTUNITY TO EARN THEREON, IN VIOLATION OF ITS CONSTITUTIONAL RIGHTS.

1. *The Commission's Expressed Concern About Regulatory Lag*[1]

[1]The term "regulatory lag" as used herein refers to that problem in an inflationary economy of the failure of a regulated utility's revenues to cover costs recognized by the regulatory commission due to the failure of the regulatory commission to grant timely rate relief.

With reference to this issue, Edison stated in its petition for rehearing, which gave rise to the rehearing upon the issue, the following:

> "In rejecting Edison's proposal for the inclusion of substantial nonoperative construction work in progress (NOCWIP) in rate base, to increase coverages and needed cash flow, the Commission referred to its decision in the PG&E case (Application No. 55509, Decision No. 86281) where it suggested possible alternatives, 'especially one that would expedite the inclusion in rate base of plant as it comes on line.' However, having recited that principle as a basis for rejecting Edison's proposal to include NOCWIP in rate base, it proceeded to reject Edison's proposal to include $66 million in plants deisgnated 'Special Items—Nonweighted' which represent investment in plant for environmental purposes or replacement plant. This plant, which does not contribute to increased capacity of the system and, therefore, is not associated with increased load or sales and revenues, was, according to the uncontracted record, to be in service as of the end of the test year."[1]

Thus, the genesis of this issue raised in Edison's petition for rehearing of Decision No. 86794 was the concern that the Commission expressed about the problem of regulatory lag in its decision in the *PG&E* case and its view that a contribution toward reducing such lag would be the expeditious recognition in rates of the impact on cost of service of new plant being

[1]Petition for Rehearing of Decision No. 86794, etc., pp. 3-4.

added to rate base. Although the Commission had indicated a desire to effect reduction in regulatory lag by more expeditious recognition in rates of additions to operative plant and rate base, it failed to apply the principle to Edison's request therein for end-of-year rate base treatment of certain items of replacement or environmental plant which Edison had designated "Special Items—Nonweighted" which would not generate increased sales and revenues to cover the costs associated therewith. Such items clearly fall in the category of nonsales-increasing, nonrevenue-increasing plant. Thinking that the Commission had, perhaps, merely overlooked the possibility of applying the principle of prompt recognition in rates of additions to operative plant and rate base to the "Special Items—Nonweighted," Edison included that issue in its petition for rehearing of Decision No. 86794 in terms quoted above.

The theory of test year ratemaking is that, if rates are fixed on the basis of a test year for the future, beyond the test year, absent significant inflation, revenues will increase as sales increase which will be adequate to cover the increased costs, including new plant investments, of operations to make the increased sales. When plant is added, such as replacement or environmental plant which does not increase the system capacity to increase sales, such increases in cost simply reduce the utility's earnings absent timely rate relief. That is what this issue in this proceeding is all about. In the proceeding below, because of the delay

in the effective date beyond the end of the test year of the full measure of rate relief to which the Commission found Edison entitled, *based on test year 1976 sales, expenses, and rate base,* the items in question when closed to plant contributed nothing to increased sales or revenues, hence immediate rate relief was required if Edison was to be afforded an opportunity to earn on that portion of its investment.

In its petition for rehearing, Edison pointed out that these "Special Items," which were closed to plant by the end of the test period being used by the Commission in fixing Edison's rates in the proceeding below, would qualify for the treatment the Commission recognized as appropriate in the *PG&E* decision which it alluded to in Decision No. 86794.[1] This was true since they represented only replacements or environmental plant, thus having no effect on Edison's system capacity or ability to generate more sales and revenues.[2]

2. *The Commission Denied Edison's Request On Grounds Urged by the Commission Staff Which Are Unsupportable.*

The Commission Staff, in its showing[3] in the reopened hearing did not even come to grips with the problem. The Staff Witness did not dispute the fact that the $37.2 million of the investment in such plant as of the end of the test year (1976) had not been recognized in the costs on the basis of which the rate increases authorized by Decision No. 86794 were determined.[4] He found no cause to believe that such costs were

[1]See Decision No. 86794, p. 76.
[2]Chubb, Ex. 133, pp. 1, 4.
[3]Ex. 132.
[4]Ibid., pp. 2-4.

unreasonable after having reviewed Edison Witness Chubb's exhibit and evaluated the cost information supplied by Edison.[1]

Yet, Staff Witness recommended that the same treatment be given the items involved in the $37.2 million of additional plant investment as any other plant, namely, inclusion in rate base on a weighted average basis.[2] This, he recognized, meant exclusion of the entire $37.2 million because it represented the difference between 1976 test year weighted average plant cost and the total year end (or nonweighted) plant cost for these items.[3]

3. *The Staff Witness's Purported Distinction Was Not Applicable To the Items in Question.*

The Staff Witness's rationale was that there are other plant costs incurred in conjunction with the addition of productive plant that could be identified as nonrevenue-producing (he cited as examples landscaping, fencing, parking in conjunction with generating plants and substations)[4] and that it is difficult to distinguish between the environmental and nonenvironmental portion of a project being constructed.[5]

However, the list of items making up the $37.2 million in additional 1976 plant investment[6] discloses that those items, almost in their entirety, do not present any such difficulty. For example, the three largest

[1]Ibid., p. 2.
[2]Ibid., p. 4.
[3]Chubb, Ex. 133, pp. 2-3.
[4]Ex. 132, p. 4.
[5]Ibid., p. 5.
[6]Ibid., p. 3.

items in the list total $32.8 million (out of the $37.2 million) and consist of the following:

Item 3.	Replacement of deteriorated poles and storm-damaged equipment — ongoing operation	$ 5,700,000
Item 7.	Undergrounding under Rule No. 20	4,400,000
Item 8.	Difference in cost of undergrounding distribution overhead construction — ongoing operation	22,700,000
Total for 3 items		$32,800,000

There can be no reasonable doubt that these items do *not* increase the capacity (capability) of the system to serve the public and thus to increase sales and revenues. Item 3 simply replaces what was there before, the omission of which would simply *reduce* the capability of the system to serve with a consequential reduction in sales and revenues. Arguably if this type of item were repeated year after year in the same order of magnitude, it could be included in expense rather than rate base. But since it represents investment in plant whose useful life extends over a period of years, it is capitalized and included in rate base.

The important consideration should be that this investment in facilities was closed to plant at or before the end of the test year and *it was concurrently removed from the ADC (allowance for funds used during construction) base at that time*. Since there are no increased sales facilitated by such plant additions, there will be no increase in revenue from the utility operations (the operations utilizing the investment in rate base) to cover the carrying cost on that investment, unless

it is recognized in rate base *and* rates as of that time, until the next general rate increase (or an offset adjustment during the interim). In the light of the expressed desire of the Commission in the *PG&E* case to avoid unnecessary regulatory lag and to give the utility an opportunity to earn on such plant, such rate base items should have been included in the final rate adjustment authorized in Decision No. 86794 which was not effective until January 10, 1977. The rates authorized thereby were not made effective until January 13, 1977, although the items were removed from the ADC base on or before January 1, 1977. Refusal of the Commission to include such items in rate base effectively denied Edison any compensation for the investment represented thereby at least from January 1, 1977, and constitutes a deprivation of property without due process of law in violation of the California and United States Constitutions (U.S. Constitution Amendment XIV, Sec. 1; California Constitution, Article I, Secs. 1, 13, 14 and 21).

What has been said in the foregoing with respect to Item 3 applies equally well with respect to Items 7 and 8, and to at least most of the other items. Items 7 and 8, involving the *difference* between the cost of undergrounding facilities and the overhead cost which would otherwise be incurred, present no difficulty in determining that such expenditures will not increase the capability of the system to provide service and generate additional sales and revenues. Clearly, these are environmental costs. The Staff Witness's difficulty in distinguishing between environmental and nonenvironmental costs[1] cannot reasonably apply here. Fail-

[1]E.g., Ex. 132, p. 5.

ure to include these items in rate base as of the end of the year 1976 and include such costs in the rate adjustments authorized herein simply and effectively denies Edison the opportunity to earn a reasonable return, in fact any return at all, on the investment represented by such plant items from the time that investment was removed from the ADC base before January 1, 1977.

In Exhibit Nos. 135 and 136 in the proceeding below Edison Witness Sample quantified the additional revenue requirements allocable to jurisdictional sales of the additional rate base associated with the items in question. Thus, the $37.2 million additional rate base associated with the items discussed above increase revenue requirements by $6.935 million allocable to retail sales or a revenue requirement of 0.017 cents per kilowatt-hour for nonlifeline sales based on test year 1976.[1] The Commission's decisions below deny Edison any compensation (return) on such investment which it has determined requires a minimum of 8.8% return to attract additional capital on a reasonable basis and not to impair its credit.[2]

4. *The Commission's Actions Are Unreasonable, Unjust, Arbitrary, and an Abuse of Its Discretion.*

Edison submits that a clear opportunity to achieve the Commission's expressed desire to reduce regulatory lag was presented in the reopened proceeding as indicated above. The record demonstrates not only the reasonableness and propriety of such additional rate increases, but the fact that absent such adjustment Edison would be denied compensation for nearly $40

[1]Sample, Ex. 135, p. 1.

[2]See Decision No. 86794, p. 23.

million of plant investment until the next general rate adjustment or other relief was granted. The unreasonableness and arbitrariness of the Commission's failure to do so is clear. It amounts to an abuse of discretion.

III

THE DISTINCTIONS RELIED UPON BY THE COMMISSION AS A BASIS FOR ITS FINDINGS 5 AND 7 AND CONCLUSION 2 WERE UNSUPPORTED BY ANY SUBSTANTIAL EVIDENCE OR AUTHORITY, AND ITS ACTIONS JEOPARDIZE EDISON AND ITS CONSUMER-RATEPAYERS AND EMPLOYEES TO LOSS OF ELIGIBILITY FOR ADDITIONAL ITC BENEFITS.

One eligibility requirement of Section 46(f)(2)(B) of the Internal Revenue Code, as indicated by the Committee Reports and as interpreted by the IRS informational rulings in the *Dallas* and *New Mexico* letters (Exhibits 126 and 127), is that the unamortized investment credit be treated as equity capital and allowed the same rate of return as that permitted all other shareholder contributed capital.[1] The evidence in the record showed that: (a) the basis of this indicated requirement is the underlying intent of Congress that the benefits of the additional investment credit be shared by both the ratepayer and the shareholder[2] and that the element of sharing under Section 46(f)(2) is achieved by permitting the full benefit of the credit provided by the Federal government[3] to be flowed

[1]Kolbe, Ex. 124, p. 10; Ex. 127, pp. 2-3.

[2]Ex. 127, p. 3; Ex. 126, p. 3; Tr. 8801-8802, 9260.

[3]*Texas Eastern Transmission Corp.*, 50 FPC 339 (1973); Reenders, Tr. 9206.

through to the ratepayer over the life of the property (the ratepayer thereby ultimately receiving the entire investment credit over an amortization period equal to the life of the property), while permitting the utility to earn on the unamortized investment credit as if it were common equity capital;[1] (b) that the ratepayer is not adversely impacted by permitting the shareholder to earn on this element of capital which has been contributed by the Federal government because this capital will replace common equity financing which the company would otherwise have made, the return on which would similarly be reflected in rates;[2] (c) that the inclusion of the unamortized investment credit as common equity capital would not change the otherwise authorized rate of return in Decision No. 86794;[3] (d) that in future test years the unamortized investment credit will merely provide an additional source of funds which would be in lieu of additional common equity financing with the result that the overall rate of return will not be increased as a result of the retention of the additional investment credit and the treatment of the unamortized credit as common equity capital.[4]

The application of such principle by the IRS is reflected in the following excerpts from the IRS information letter to the Public Service Commission of New Mexico (Exhibit 127):

> "The circumstances are understood to be these. The Company is a 'regulated public utility' as defined in section 7701(a)(33) of the Code; it

[1]Ex. 127, p. 3.
[2]Reenders, Tr. pp. 9220-9223; 9241.
[3]Reenders, Tr. pp. 9212-9214; 9241-2.
[4]Reenders, Tr. p. 9263.

> holds 'public utility property' within the meaning of section 46(c)(3) of the Code; certain of the property qualifies for the investment tax credit under the provisions of section 1.46-3(g) of the regulations; and the Company exercised a proper and timely election as provided by section 46(c)(2) (now section 46(f)(2)) of the Code as to the preferred accounting treatment of the credit for ratemaking purposes. The effect of this election from the standpoint of investment tax credit availability is noted in the discussion of the basic question set out in the later part.
>
> "It is further understood that in the rate proceeding before the Commission, the Company proposed that for ratemaking purposes, the reserve for accumulated deferred investment tax credit be included with the common stock in the derivation of the Company's composite capital structure for use by the Commission in the determination of an overall rate of return to be applied to the utility rate base. Because the Commission does not contemplate any direct adjustment to the utility rate base, the inquiry centers on the question of whether or not the Company's proposal should be accepted as proper in order that the availability of the investment credit not be jeopardized.
>
> "The inquiry is answered in affirmative based upon the effect of the Company's election under section 46(f)(2) of the Code. Upon the exercise of this option, the investment credit is not to be available to a utility with respect to any of its otherwise qualified public utility property if: (a) there is any adjustment to reduce the rate base; or (b) if the credit to which it would otherwise

be entitled is flowed through to income faster than ratably in the period of time over which depreciation expense is computed on the utility's regulated books of account.

"In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect a utility's permitted return on investment by treating the credit in any way other than as though it had been contributed by the utility's common shareholders. This means that the cost of capital rate assigned to the credit cannot be less than the rate assigned to the common shareholders' investment. If a lesser rate were to be so assigned, it would be treated as, in effect, a rate base adjustment and the credit would be unavailable.

"Accordingly, in determining the overall cost of capital of a utility for ratemaking purposes, deferred investment tax credits are properly to be included and assigned a rate not less than that considered applicable to common equity. It follows that the unamortized investment credit, or that portion of the credit which has not yet been flowed through to income is appropriately to be included in the total capital of a utility on which a rate of return is to be allowed.

"This procedure implements the intent of the Congress that the benefits of the credit be shared between investors and customers. While a utility would be permitted to earn a return on the unamortized investment credit, the ratable amortization of the credit reflected in the utility's cost of service would result in increased revenue for

ratemaking purposes with a corresponding reduction in the utility's rates."

See also IRS letter to the City of Dallas (Exhibit 126).

Decision No. 87828, while recognizing that IRS information letters are provided in the interest of sound tax administration in answer to inquiries by individuals and organizations to call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts (Opinion, p. 13), is based upon distinctions which the Commission develops in its Decision and which it concludes renders the principle reflected in the *Dallas* and *New Mexico* letters "completely inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure" (Opinion, p. 13). The Commission's Findings 5 and 7 and its Conclusion 2 in the Decision were based upon such distinction developed by the Commission. There is no substantial evidence in the record to establish that the IRS had heretofore or could be predicted to recognize either the appropriateness of such distinctions under the Federal tax laws or that the tax principles enunciated by it in the *New Mexico* and *Dallas* informational letters would be inapplicable in the case at bar. Nor was there any authority relied upon or cited by the Commission in support of the inapplicability of such tax principle. The record in this case does not contain substantial evidence in support of the aforesaid findings and conclusions in the Decision.

As reflected in its application to the Commission for rehearing of Decision No. 87828, Edison has sought

the cooperation of the Commission in seeking a prompt revenue ruling from the IRS concerning Edison's eligibility for the additional ITC benefits, and the Court should be advised that by letter dated September 22, 1977, which was in a form that the Commission had had an opportunity to review, a request for a revenue ruling was made to the Commissioner of Internal Revenue with respect to the effect of said Decision No. 87828 (Southern California Edison Company ID No. 95-1240335). If the IRS issues a favorable ruling on the basis of such distinctions or otherwise,[1] this particular problem of the treatment by the Commission of the return on unamortized investment credit will of course be resolved. But, absent a favorable ruling by the IRS, the jeopardy to Edison and its consumer-ratepayers and employees[1] of the loss of eligibility for the additional ITC benefits is not eliminated and this jeopardy is substantial.[2]

The Commission's Decision No. 87828, while clarifying certain actions taken by the Commission in its earlier related Decision No. 86794, did nothing to modify, clarify or correct the defects involved in the

[1]There was testimony in the record upon which the IRS could appropriately reach the same result from a different standpoint; cf., Reenders testimony, Tr. 9212-14.

[1]Decision No. 86794 not only subjects Edison to the possibility of loss of the additional investment credit, but also involves the possibility of loss of eligibility for the additional benefits to employees under an employee stock ownership plan (TRASOP); Kolbe Ex. 124, pp. 19-20; Ex. 128, pp. 16-17; Tr. p. 8824.

[2]It was estimated by Witness Reenders that loss of eligibility would result in a lost tax credit for the years 1975 and 1976 involving approximately $16,000,000 and an estimated loss through 1980 in excess of an additional $138,000,000; Reneders Ex. 130, p. 5; Ex. 131, Table 1 (exclusive of TRASOP benefits).

Commission's failure to meet the tests laid down as to adequacy of allowance on common equity by the cases of *FPC v. Hope Natural Gas Co.,* 320 U.S. 591 (1944), and *Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Comm.,* 262 U.S. 679 (1923); cf., *New England Tel. & Tel. v. Department of Public Utilities,* 354 N.E.2d 860 at 867 (1976), as set forth in Edison's Petition for Writ of Review heretofore filed with this Court (No. S.F. 23605).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Commission has committed substantial error in taking the actions herein discussed which it took in the case at bar. The effect of such actions has been to deny Edison the opportunity to earn a return upon property which it has devoted to public use contrary to law and thus to deny petitioner its constitutional rights and in addition to jeopardize its eligibility for very substantial ITC benefits to the detriment of Edison, its ratepayers and employees.

It is respectfully submitted that the actions of the Commission excluding from rate base the "Special Items —Nonweighted" be annulled and that this matter should be remanded to the Commission for further deliberations and modifications of Decision No. 87828 consistent with the Court's determination herein requiring the Commission to regularly pursue its authority and to avoid Edison and its ratepayer-consumers and employees being denied substantial benefits in the form of increased ITC allowances under the Tax Reduction Act of 1975 and later enactments.

Southern California Edison Company respectfully requests that this Court issue a writ of review herein and consolidate argument with No. S.F. 23605.

Respectfully submitted,

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DATED: November 15, 1977.

APPENDIX I

I
BACKGROUND OF PROCEEDINGS

"The Decision of which petitioner seeks review resulted from the following proceedings:

"1. On June 7, 1974, petitioner filed Application No. 54946 with the Commission requesting authority to increase its rates applicable to retail electric utility service in the State of California by an amount which would produce an estimated increase in revenues based upon test year 1976 of approximately $339 million.

"2. On May 13, 1975, the Commission instituted an investigation regarding the investment credit provisions of the Tax Reduction Act of 1975[2] (on less than 10 days' notice because the utilities' election under

[2]P.L. 94-12.

the Act had to be made by June 26, 1975) and then on June 17, 1975, ordered the investigation discontinued because the Commission was not able to agree on a result.[3]

"3. On June 25, 1975, petitioner elected Option No. 2, ratable[1] flow-through of the increase in ITC benefits under the Tax Reduction Act of 1975.[2] Such election was for the reasons disclosed in the evidence which Edison presented in Case No. 9915 and in conformity therewith.[3]

"4. After full public hearings in connection with Application No. 54946, the Commission on December 21, 1976, issued Decision No. 86794 which (together with the partial general rate increase authorized December 30, 1975, by the Commission as an initial phase but not as final disposition of the matter—Decision No. 85294) authorized an aggregate increase in Edison's base rates amounting to approximately $122 million. In rendering Decision No. 86794, the Commission approved rates predicated upon estimates of sales and revenues, expenses, rate base and rate of return adopted by the Commission for the test year 1976. . . ."

[3]Case No. 9915, Dec. No. 84568.

[1]Based on book life of plant which generated the credit (Section 46(f)(6), I.R.C.).

[2]Ex. 87, p. 1.

[3]Ex. 87, pp. 11, *et seq.*

APPENDIX 8.

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23605.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Claire T. Dedrick, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23723.

REPLY OF PETITIONER
TO ANSWER OF RESPONDENT

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In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L.

Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23605.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Claire T. Dedrick, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23723.

REPLY OF PETITIONER
TO ANSWER OF RESPONDENT

TO THE HONORABLE ROSE ELIZABETH BIRD, CHIEF JUSTICE, AND TO THE HONORABLE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE STATE OF CALIFORNIA:

Petitioner, Southern California Edison Company (Edison), respectfully submits its reply to Answer of respondents, Public Utilities Commission (Commission), to the petitions for writ of review in the aforesaid dockets, as follows:

I

The Commission incorrectly applied the standards for utility ratemaking established by the United States Supreme Court in a number of respects.

A. The Commission's Decision No. 86794 indicated that the Commission, while citing the cases of *Federal Power Comm. et al., v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 615, and *Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Comm.* (1923) 262 U.S. 679, 692-3, was operating under the misconception, in fixing Edison's rates, that such United States Supreme Court cases *precluded*

the Commission, in the exercise of its jurisdiction, from authorizing rates which would be higher than the minimum amount required to enable the Company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed; this is a demonstrably inaccurate regulatory standard or limitation upon a regulatory commission's authority that is not required by the United States Supreme Court decisions relied upon by the Commission.

1. Opinion No. 86794 stated (mimeo., p. 7): "The United States Supreme Court has broadly defined the revenue requirements of utility companies as being the minimum amount which will enable the company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (*Federal Power Commission, et al., v. The Hope Natural Gas Company* (1944) 320 US 591, 605; 88 L.ed. 333, 346) and will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties (*Bluefield Waterworks and Improvement Company v. West Virginia Public Service Commission* (1923) 262 US 679, 692, 693; 67 L.ed at 1176)."

2. While it is clear that such United States Supreme Court decisions establish, as a *constitutional* question, that rates which do not meet such minimum standards are constitutionally impermissible, there is nothing in said decisions to

suggest that a regulatory commission, in carrying out its responsibilities to fix just and reasonable rates, cannot lawfully set rates at a higher level than such constitutional minimum where it is persuaded that the conditions justify it. To the contrary, the United States Supreme Court stated, in *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 317, ". . . we have emphasized that the courts are without authority to set aside any rate adopted by the commission which is within a 'zone of reasonableness' . . ." There are numerous cases, including earlier decisions of the California Commission, where the setting of rates higher than the minimum within such zone of reasonableness has been deemed appropriate and has been lawfully done (e.g., *Southern California Edison Company* (1971) 72 CPUC 282, 289; *Pacific Telephone and Telegraph Company v. PUC* (1950) 34 C.2d 822, 829; *Banton v. Belt Line Ry. Corp.* (1925) 268 U.S. 413, 422-4).

3. In the Answer filed on behalf of the Commission, great reliance is placed upon the assertion (pp. 7-12) that in this proceeding the Commission had an abundance of statistical evidence—which is correct. But, it is also correct that the availability of all the statistical evidence in the world can be no cure or justification if, as indicated in the opinion, the Commission felt constrained, because of an improper legal standard being applied by it to such statistics, from allowing higher rates (because of an incorrect interpretation of the said United States Supreme Court decisions, i.e., that it could not lawfully permit higher rates than such minimum).

4. Despite the repeated assertions in the Answer of respondents that the Commission adopted a rate of return that fell within the top and the bottom of the ranges which had been proposed by various participants in the proceedings, it is manifestly clear from Decision No. 86794 that the Commission did set rates designed to produce what it considered to be *the minimum*.[1]

5. Inasmuch as the Commission's Legal Staff, in the Answer now filed on behalf of the Commission, "admits, as it must, that neither *Hope* nor *Bluefield* require that the 'minimum,' rate of return found to be reasonable must be the one adopted" (p. 11 of its Answer), it must be pointed out that this issue was raised in Edison's petition for rehearing dated January 7, 1977,[1] and that the Commission, as distinguished from its Legal Staff, neither granted rehearing on that issue nor clarified nor corrected nor denied that it had felt legally obliged, in issuing its Decision, to fix utility rates at such minimum, nor denied that it had applied such an improper standard.[2]

6. It is abundantly clear that a rate of return which should be allowed by a regulatory commission in any particular rate proceeding normally falls within a range of reasonableness and that a rate of return which is the minimum necessary to avoid unconstitutional confiscation is rarely the

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[1]E.g. Dec. 86794 (mimeo) p. 23.

[1]See "Petition of Southern California Edison Company for Rehearing of Decision No. 86794 or for Reconsideration and Modification Thereof" dated January 7, 1977, pp. 1-3.

[2]Decision No. 86986 dated February 15, 1977, denying rehearing as to this issue.

same (cf., *New England Tel. Co. v. Dept. of Public Utilities,* 354 N.E.2d 860, 868).

B. In addition, in fixing Edison's authorized rate of return in these proceedings, the Commission failed properly to apply the tests for an adequate rate of return laid down in the *Hope* and *Bluefield* cases.

1. It is respectfully submitted that when a utility is denied the opportunity, as in this case, to earn a return which would avoid continued dilution of existing shareholders' interests, the tests of the aforesaid cases as to the adequacy of the return allowance has not been met. To state the matter in another way, a rate which assures continued dilution of existing shareholders' interests cannot be considered adequate under *Bluefield.*

2. The *Hope* and *Bluefield* decisions of the United States Supreme Court have laid down the tests of adequacy of earnings allowance for common equity in the following terms: they must be comparable to earnings on investments of similar risk, must be such as not to impair the credit of the utility, and must enable the utility to attract new capital.

3. It is demonstrably clear that the Commission's decisions in these proceedings fail to meet these tests.

a. That the Commission's adoption of a 12.6 percent return on common equity, for the purpose of determining the minimum rate of return it used in fixing rates, is grossly inadequate to permit Edison's common stock when marketed to yield net proceeds approximating book

value, is clearly indicated not only by the Company's experience after the partial general increase authorized by Decision No. 85294 on December 30, 1975 (after which Edison's common stock throughout 1976 continued well below book value, never reaching as high as $24.00 per share although the book value as of December 31, 1973, was over $28.00,[1] but by the further fact that since the issuance of its Decision No. 86794 Edison's common stock has continued to sell well below book. It must, of course, be recognized that if new stock yields net proceeds less than book value, the equity of existing shareholders is subjected to forced dilution (cf., *New England, Tel. & Tel. Co. v. Dept. of Public Utilities,* 354 N.E. 2d 860-867).

b. It is equally clear that Edison has been denied the opportunity to produce earnings comparable to those on investments of similar risks, as indicated by the fact that the stock of Edison, like other major California utilities, has continued to sell substantially below book (over 20 percent below book value),[1] while those of most other similar electric utilities in the country sell at prices which approach or exceed book value.

c. In this connection, the Answer filed on behalf of the respondents misstates the position of petitioner when it asserts, on page 12, that

[1]Exhibit 2, Tab. 5-C, p. 5-4.

[1]This condition is no doubt a significant factor causing the administrators of the State of California pension funds to refrain from investing in such securities of California utilities.

petitioner suggests that the adopted return on equity of 12.6 percent fails to meet the *Hope* and *Bluefield* guidelines "because that return will not assure that the petitioner will be able to issue new shares of common stock at a net price equal to book value."[1] Petitioner's position, correctly stated, is that it is entitled, under such decisions, to have the opportunity to earn a return which will meet the tests laid down in those decisions and that regulatory decisions, such as that involved in the case at bar, which practically assure that the petitioner will not have such opportunity, is unlawful and denies the petitioner its constitutional rights. This is recognized in the decision of the Massachusetts Supreme Court in *New England Tel. and Tel. Co. v. Dept. of Public Utilities,* 354 N.E.2d 860. The "balancing of interests" concept discussed in the Answer (p. 13) has never to our knowledge heretofore been advanced as a justification for fixing rates below a minimum confiscatory level.

To suggest, as Counsel for the Commission has done at page 14 of the Answer, that such *New England* decision "does not even make a pretense of following the *Hope* and *Bluefield* decisions" (apparently because the decisions are not specifically cited), is palpably inappropriate. While it is true that the Massachusetts Supreme Court in that decision cited only other Massachusetts Supreme Court cases, a number of

[1]Elsewhere in the Answer (at page 18, lines 4-5), Commission counsel appears correctly to recognize that it is Edison's position that a rate of return must allow a utility a reasonable opportunity to sell its common stock at book value.

those other Massachusetts cases did cite the *Hope* and *Bluefield* decisions and applied the ratemaking principles established by them.[1] It cannot thus reasonably be suggested that the Massachusetts Supreme Court, in the *New England* case referred to, did not have the *Hope* and *Bluefield* ratemaking principles in mind. The purported distinction in the Answer based upon the differing rate-fixing method utilized in Massachusetts is specious. The *Hope* case stands for the proposition that no specific rate-fixing method is required and the end result is the test. Where the end result is continued dilution of the stockholders' equity such result under any method is unlawful. The legal requirement that utilities are to be given the opportunity to earn a fair return is not different in an original-cost regulatory jurisdiction from a fair-value regulatory jurisdiction.

d. With respect to the Commission Counsels' suggestion that when the Massachusetts

[1]With respect to the cases referred to in the *New England* decision in this connection, *New England Tel. & Tel. v. Dept. of Public Utilities,* 97 N.E.2d 509 (1951), *New England Tel. & Tel. v. Dept. of Public Utilities,* 121 N.E.2d 896 (1954), *New England Tel & Tel. v. Dept. of Public Utilities,* 275 N.E.2d 493 (1971), *Boston Gas Co. v. Dept. of Public Utilities,* 336 N.E.2d 713 (1975), and *Boston Gas Co. v. Dept. of Public Utilities,* 269 N.E.2d 248 (1971) *cited Hope* and/or *Bluefield; Dept. of Public Utilities v. New England Tel. & Tel.,* 90 N.E.2d 328 (1950), *Boston Gas Co. v. Dept. of Public Utilities,* 324 N.E.2d 372 (1975), *Southbridge Water Supply Co. v. Dept. of Public Utilities,* 331 N.E.2d 523, *Salisbury Water Supply Co. v. Dept. of Public Utilities,* 184 N.E.2d 44 (1962), *Liberty Mutual Ins. Co. v. Comm. of Ins.,* 313 N.E.2d 897 (1974), *Boston Gas Co. v. Dept. of Public Utilities,* 329 N.E.2d 712 (1975), and *New York Central R.R. v. Dept. of Public Utilities,* 199 N.E.2d 319 (1964) *did not, but all applied the same ratemaking principles.*

Supreme Court stated: "If new stock yields net proceeds less than book value, the equity of existing stockholders is diluted; and forced dilution is confiscation, at least in the absence of some explanation not present in this case," that the Massachusetts Court left a "loophole," it should suffice to point out that in the respondent Commission's decision involved in the case at bar there was similarly the absence of any explanation as to why there should be forced dilution of the interests of existing stockholders because of inadequate allowance of return on equity.

e. The reliance placed in the Answer upon the case of ***Market Street Railway Co. v. California Railroad Commission,*** 324 U.S. 548 (Answer, page 29), is misplaced. While such case stands for the proposition that the Commission is not bound by any particular expert testimony, it clearly does not stand for the proposition that the findings and conclusions of the Commission can appropriately be predicated upon no evidence. In the ***Market Street Railway*** case, the Court found there to be ample evidence to support the Commission's findings in that proceeding.[1] To the contrary, in this case, the Commission's Findings 5 and 7 and its Conclusion 2 in Decision No. 87828 are predicated upon distinctions developed by the Commission in Decision No. 87828 in the absence of any testimony or evidence in the proceedings sup-

[1]*Market Street Railway v. Calif. Railroad Comm.,* 324 U.S. 548, 558-562.

portive of such distinction, and they are unsupported by any evidence or precedential authority.

II

Having set the authorized rate of return at the minimum found by the Commission to be necessary, the Commission then, by its decisions, produced results which precluded Edison from any opportunity to earn even such minimum for the test year.

A. In its determination of Edison's minimum additional revenue requirements, the Commission assumed and reflected the continued receipt by Edison of the additional investment tax credit benefits provided by the Tax Reduction Act of 1975, as extended by the Tax Reform Act of 1976. It is obvious that any invalidity in this assumption of continued eligibility for the additional investment tax credit benefits would result in Edison's being denied any opportunity to earn as much as the return that had been determined by the Commission to be the minimum required.

1. In its Decision No. 86794, the Commission included a paragraph (mimeo., page 22) which was subject to an interpretation that, after initially determining a rate of return, it had made a subsequent adjustment downward in the rate of return because of Edison's election of Option 2 under the Tax Reduction Act of 1975, which could result in the loss of Edison's eligibility for the additional investment tax credit.

a. At the time of the issuance of said Decision No. 86794, Edison was aware of a then recent ruling by the Internal Revenue Service, in the Southern California Gas Company matter[1] involving questions of eligibility for additional investment tax credit benefits, indicating that in that case the Internal Revenue Service had taken the position that actions of the Commission resulted in a loss of such eligibility.

b. In view of the aforesaid language in Decision No. 86794 and the provisions of Section 46(f) of the Internal Revenue Code (indicating that increased investment tax credit benefits, under the Tax Reduction Act of 1975, would be denied to utilities who had elected Option 2 when the benefits thereof were faster than ratably flowed through to the ratepayer), Edison sought the advice of independent outside legal tax counsel. After review of Decision No. 86794 and the applicable tax laws, such expert concluded that Edison's ability to avail itself of those increased investment tax credit benefits for all open tax years as well as for the future was in serious jeopardy. Edison then sought a reopening of the case, which was granted by the Commission.

c. In its subsequent Decision No. 87828 (opinion on rehearing and reopening), the Commission clarified what it had done in determining rate of return and stated that it had not arrived at a reasonable return on equity exclusive of Option 2 benefits and then adjusted the figure downward to reflect the Option 2 benefits (mimeo., pages 10 and 11). It indicated that instead it had included all relevant ratemaking factors, including the Option 2 benefits,

[1]I.R.S. Ruling T:C:E:A:3, Ex. 125.

as a whole, in making its initial determination as to the reasonable rate of return. Edison, of course, accepts this clarification by the Commission of what it did and did not do with respect to this aspect of its deliberations on rate of return.[1]

2. In its Decision No. 87828, the Commission also dealt with another eligibility factor that is involved concerning the additional investment tax credit, namely, a requirement, as evidenced by two information letters that had been issued by the Internal Revenue Service, to the effect that the unamortized investment tax credit be treated as equity capital and allowed the same rate of return as that permitted on other shareholder contributed capital in order to obtain eligibility.[2]

a. While recognizing that the Internal Revenue Service information letters are provided in the interest of sound tax administration in answer to inquiries and that such letters purport to call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts (Dec. No. 87828, [mimeo.,], page 13), the Commission distinguished the application of such principles in those information letters from the case at bar and based its Findings 5 and 7 upon such distinctions. There was no substantial evidence in the record to establish that the Internal Reve-

[1]As set forth *infra* p. 14, Edison has sought a ruling from the Internal Revenue Service; in such request it has advised the IRS of this clarification. No ruling has as yet been issued by the IRS.

[2]Exhibits 126 and 127.

nue Service had heretofore, or could be predicted to, recognize the appropriateness of such distinctions, relied upon by the Commission, under the federal tax laws,[1] nor were there any authorities supportive of such distinctions referred to in the decision of the Commission. Since the Commission's conclusions as to continued eligibility for the additional investment tax credit benefits were predicated upon the distinctions relied upon by the Commission, absent a favorable ruling by the Internal Revenue Service in this regard, the jeopardy to Edison and its customers of the loss of eligibility persists.

b. On September 22, 1977, after Decision No. 87828 was issued, Edison filed a request with the Internal Revenue Service for a revenue ruling as to such eligibility, after providing the Commission with an opportunity to review the form of its request.[2]

3. Loss of eligibility, for any reason, of the investment tax credit benefits could result in approximately \$150 million of tax increases to the Company for the period 1975 through 1980, and would preclude over \$300 million in reduced revenue requirements being ratably flowed through to the rate payers over the life of the property.

In addition, such disallowance could also result in the loss to the approximately 13,000 Company employees of some \$26 million in Company stock over the same period because of the related possi-

[1]The Answer recognizes that the IRS has not concurred or ruled upon such matter (Answer, page 29).

[2]Such request for revenue ruling has not as yet been acted upon by the IRS.

bility of loss of eligibility for the additional investment tax credit provided by the federal government under the Employee Stock Ownership Plan, known as TRASOP or ESOP (Section 46(a)(2)(b) of the Internal Revenue Code).[1] Under the TRASOP provisions Congress has in effect granted benefits to be shared by the ratepayers, the shareholders, and the utility employees.

Such benefits are designed to be utilized to help finance the construction needs of the utility industry, while at the same time providing ratable rate relief to the ratepayers.

4. The suggestion on page 24 of the Answer filed on behalf of the Commission that Edison had never raised the question of the risk of loss of eligibility for increased investment tax credit benefits is demonstrably incorrect. The Answer mistakenly asserts that the quoted portion from Edison's petition for rehearing, dated January 7, 1977, which refers to the fact that "the Commission ignored completely and made no adjustments in rate of return for the *added* risks to Edison resulting from the actions thereafter taken in its Decision," did not encompass the question of risk of loss of eligibility for increased investment tax credit benefits; in so doing, it ignores the fact that in said petition for rehearing Edison objected to the Commission's determinations reflected in Finding 5i, which specifically related to the additional investment tax credit benefit allowances, and the fact that the question of the risk of loss of eligibility was fully briefed before the Commission in the proceedings which culminated in

[1]Ex. 124, pages 19-20; Ex. 128, pages 16-17; Tr. p. 8824.

said Decision No. 86794.[1] That this issue was covered by said petition for rehearing was heretofore recognized by the different Staff Counsel, who participated actively in the proceedings; this is demonstrated by the fact that in opposing Edison's second petition for rehearing and reconsideration, dated February 18, 1977, such Staff Counsel stated: "The instant petition seeks rehearing of D 86794 'on issues relating to the Commission's treatment of investment tax credit ("ITC") and rate of return in Decision No. 86794.' The original petition for rehearing raised these very issues." (See Response of Commission Staff to Petition of Southern California Edison Company for Rehearing and Reconsideration of Decision Nos. 86794 and 86986 and For Reopening of Record To Take Additional Evidence, page 1).

Inasmuch as the Commission, in fixing Edison's rates at a level designed to produce what it deemed to be the minimum rate of return, assumed continued eligibility for the investment tax credit benefits, it is obvious that the loss of such benefits would deny Edison any opportunity to earn even such minimum return.

B. Since final adjustment in Edison's base rates did not become effective until after the 1976 test year, it is clear that the petitioner could not possibly earn the authorized minimum rate of return, and the rates in effect during the test year were, to that extent, confiscatory.[1] The Answer filed on behalf of the Com-

[1]See Edison's brief, pages 37 and 38.

[1]The Answer filed on behalf of the Commission, at page 15, et seq., appears to confuse the adverse effect of attrition due to inflation with the adverse effects of delayed rate relief during the test year. The two are separate problems, although they can be interacting.

mission as to this issue asserts, on page 9, that "the petitioner overlooks the fact that 80 million dollars in increased rates did in fact go into effect at the beginning of the test year when the Commission granted petitioner's request for interim rate relief. As to that amount, the only effect of the decisions under appeal was to make that increase final." The inadequacy and inappropriateness of this response is that the Commission's Decision No. 86794 determined that the *minimum* return for the test year was $44 million *higher* than the $80 million that was granted, and it is, we respectfully submit, patently clear such *additional* amount is some measure of the extent to which there has resulted unlawful confiscation because of the circumstance that the petitioner was deprived of the opportunity to earn even the minimum required return during the test year.

III

Rate Base Issue

A. In the Answer filed on behalf of the Commission, at page 31, it is inaccurately suggested that Edison's proposed rate base treatment of the Special Items —Non-weighted would allow Edison "to earn twice on portions of those plant items." The record clearly shows that such investment in facilities was close to plant at or before the end of the test year and it was concurrently removed from the ADC (Allowance for Funds Used During Construction) base at that time.[1]

B. It is argued in such Answer that the Commission's treatment of such rate base items was discretionary with the Commission. In response to this contention, it is respectfully submitted that an abuse of discretion, as outlined in Edison's petition to this Honorable Court, constitutes reversible error.

[1]Ex. 133 pages 3-4.

C. Inasmuch as it is only in recent times that the amounts required for environmental reasons that utilities must invest in such nonrevenue producing plant additions has reached the magnitude of the millions, it is perhaps not surprising that the issue has not heretofore apparently reached the courts upon the due process question presented by Edison's petition.

IV

Counsel for the Commission are clearly in error in suggesting (pages 5, 17 and 18 of the Answer) that this Honorable Court is precluded in its review from going behind the findings and conclusions of the Commission, and that such findings are final and not subject to review (citing §1757 of the Public Utilities Code) when constitutional issues, such as those raised in the case at bar are involved. Commission Counsel have ignored the provisions of §1760 of the Public Utilities Code providing that:

> "In any proceeding wherein the validity of any order or decision is challenged on the ground that it violates any right of petitioner under the Constitution of the United States, the Supreme Court shall exercise an independent judgment on the law and the fact, and the findings or conclusions of the commission material to the determination of the constitutional question shall not be final."

as well as prior decisions of this Court: See *Southern California Edison Company v. Railroad Commission* (1936) 6 C. 2d 737; *American Toll Bridge Co. v.*

Railroad Comm. (1938) 12 C. 2d 184; *Huntley v. Public Utilities Comm.* (1968) 69 C. 2d 67.

V

The granting of these petitions is not only fully justified on the merits, but they should be granted as well from an additional standpoint. If such petitions were to be denied before the issuance of an IRS ruling such denial could effect "a final determination" within the meaning of the Internal Revenue Code.[1] The result could then be to preclude the Commission or the Court from being able to take any further curative action, should the IRS ruling contain some conditions for eligibility which would otherwise have been acceptable to the Commission. The net result would be the loss of millions of dollars of additional investment tax credit benefits, to the detriment of California electric consumers and to Edison's employees which, under the postulated conditions, nobody would have wanted and which would have been unnecessary (e.g., PUC Dec. No. 87838, Finding 12).

Southern California Edison Company respectfully submits that its petition for writ of review should be granted and requests this Honorable Court to issue such writ.

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WILLIAM E. MARX
DENNIS G. MONGE
/s/ By Rollin E. Woodbury
Attorneys for Petitioner
Southern California Edison Company

[1]Internal Revenue Code Sec. 46(f).

VERIFICATION

I, EDWARD A. MYERS, JR., declare and state that I am a Vice President of Southern California Edison Company, petitioner in the above-entitled actions, and that I make this declaration for and on behalf of said petitioner. I have read the foregoing Reply of Petitioner to Answer of Respondent and hereby declare and state that the contents thereof are true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

DATED: May 22, 1978.

/s/ Edward A. Myers, Jr.
Edward A. Myers, Jr.

APPENDIX 9.

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23605.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Claire T. Dedrick, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23723.

PETITION FOR REHEARING

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July 6, 1978

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California,

Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23605.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission of the State of California, Robert Batinovich, William Symons, Jr., Vernon L. Sturgeon, Claire T. Dedrick, and Richard D. Gravelle, the members of and constituting said Public Utilities Commission, Respondents. S.F. No. 23723.

PETITION FOR REHEARING

TO THE HONORABLE ROSE ELIZABETH BIRD, CHIEF JUSTICE, AND TO THE HONORABLE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE STATE OF CALIFORNIA:

Pursuant to Rule 27 of the Rules of Practice and Procedure adopted by the Judicial Council and the Supreme Court of the State of California, Southern California Edison ("Edison") hereby petitions this Honorable Court for rehearing of the decisions heretofore filed by this Court on June 22, 1978, denying Edison's petition for writ of review in Docket Nos. SF 23605 and SF 23723.

I

Preliminary Statement

In the belief that neither this Court, nor any other fair-minded court, could be expected to conclude that there was not an unlawful confiscation where a state regulatory commission had ordered utility rates designed to produce only the *minimum* revenue required by law and in so doing had erroneously assumed the existence of a credit without which the rates would

produce less than the minimum required by law, we feel that the Court's attention may not have been adequately directed to or focused upon this aspect of the matter involved in aforesaid dockets. The logic supportive of such belief may be set forth in syllogistic form as follows:

Major Premise: Anything below the minimum required by law is confiscatory.

Minor Premise: Rates here were designed to produce, with the inclusion of the assumed benefit of the Investment Tax Credit, the minimum required by law.

Conclusion: Without the assumed benefit of the Investment Tax Credit, the rates designed here would be below such minimum and would thus be confiscatory.

We are therefore respectfully petitioning the Court for its reconsideration.[1]

II

Undisputed Facts

In the case at bar involving the aforesaid dockets, the following facts are indisputable from the record:

1. Whether because of a misconception of the decisions of the United States Supreme Court[1] or otherwise, it cannot be disputed that the Commission stated in its decision that the rate of return which it was authorizing was one which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the

[1]cf, Docket No. SF 23531; *People v. Western Air Lines* 42 C.2d 621 (1954).

[1]See Reply Brief of Petitioner to Answer of Respondent, Docket Nos. S.F. 23605 and 23723, p. 2 et seq.

credit of Edison" (Decision No. 86794, Page 23). *Federal Power Commission v. Hope Natural Gas Company* 320 U.S. 591, 605 (1944); and *Bluefield Water Works and Improvement Company of West Virginia v. West Virginia Public Service Commission* 262 U.S. 679, 692-693 (1923).

2. In adopting such minimum revenue requirement for Edison, it is indisputable that the Commission assumed in its decision that the increase in Investment Tax Credit (ITC) benefits provided by the Tax Reduction Act of 1975 would not be lost because of actions taken by the Commission in said decision but rather would be retained and available to Edison as a credit to be taken into account in determining its revenue requirements. (Decision No. 86794, p. 64-68; Decision No. 87828, Findings 1 and 2, p. 18, and Conclusion 1, p. 19).

3. If, contrary to the Commission's assumption, such ITC credits are not to be available to Edison, it necessarily follows that the authorized rates (which were designed upon the assumption of the continued availability of such credits) would not be designed to produce the minimum revenue requirement provided by law and would at least to that extent be unlawfully confiscatory.

4. As fully disclosed in Edison's petitions heretofore filed, Edison, after the clarifying decision by the Commission (Decision No. 87828) sought a revenue ruling from the Internal Revenue Service (IRS), concerning Edison's eligibility for the additional Investment Tax Credit benefits, by letter dated September 22, 1977, which was in a form that the California Commission had had an op-

portunity to review before it was filed. To date the IRS has not ruled upon the question, and, while Edison hopes to obtain a favorable ruling, in light of the clarifications by the Commission in Decision No. 87828 and the differences believed to exist between the factual situations in those cases involving other California utilities,[1] Edison would suffer irreparable damage should a similar negative IRS ruling issue in the Edison case.

The amounts involved are substantial[1] and the loss of such additional ITC benefits could adversely impact not only Edison's ratepayers and customers but its employees as well because of the TRASOP aspects of the matter.[2]

Under these circumstances we sought, among other things, to bring to the Court's attention that if, before the issuance of an IRS ruling, a determination of such issue were to become a "final determination" within the meaning of the Internal Revenue Service Code Section 46 (f), the result could then be to preclude the Commission or the Court from being able to take any future curative action should the IRS ruling contain some conditions for eligibility which would otherwise have been acceptable. The net result

[1]E.g. Ex 125 Southern California Gas Company Ruling (T:C: E:A:3).

[1]The evidence indicates that loss of eligibility would result in a lost tax credit for the years 1975 and 1976 involving approximately $16 million and an estimated loss through 1980 in excess of an additional $138 million (exclusive of the loss of TRASOP benefits). Reenders Exhibit 130, p. 5; Exhibit 131, Table 1.

[2]Loss of eligibility would also involve possibility of loss of benefits to employees under TRASOP. Kolbe Exhibit 124, pp. 19-20; Exhibit 128, pp. 16-17, Transcript 8824.

would be the loss of millions of dollars of investment tax credit benefits to the detriment of California electric consumers and to Edison employees which, under the postulated conditions, nobody would have wanted and which would have been unnecessary (e.g. Public Utilities Commission Decision No. 87838, Finding 12). The Commission itself has recognized that continued eligibility for investment tax credit is in the public interest. For example, it stated in said Decision 87838 that:

> "Eligibility is the first issue to be determined. To render a decision which attempts to resolve these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision. In the final analysis a loss of eligibility to the utilities would not only create service problems (though certainly not of the scope described by the Pacific's [sic]) but would create staggering financial problems to be ultimately borne by the ratepayers whose interest we are attempting to redress. We believe that eligibility for these tax benefits should be retained and proceed on that basis. (Decision, pp. 19-20)."

5. The rates fixed by the Commission for Edison have not provided any opportunity for it to sell new issues of its common stock except at prices *below* book value with the resultant dilution of the equity interest of its existing common stockholders.

III

Argument

1. THE RATES FIXED BY THE COMMISSION FOR EDISON FAIL TO MEET THE TEST FOR AN ADEQUATE RATE PRESCRIBED BY THE UNITED STATES SUPREME COURT AND DENY IT THE OPPORTUNITY TO EARN AN ADEQUATE RATE OF RETURN IN VIOLATION OF ITS CONSTITUTIONAL RIGHTS.

As has been recognized by this Honorable Court, the general approach employed by the Commission for determining what constitutes permissible rates is to determine with respect to a "test period" (1) the rate base of the utility, (2) gross operating revenues, and (3) costs and expenses allowed for rate making purposes, resulting in (4) net revenues produced or return sometimes termed, "results of operations". Then by determining the rate of return to be fixed or allowed upon its rate base and comparing the net revenue which would be achieved at that rate with the net revenue of the test period, the Commission determines how much the utility's rates and charges should be raised or lowered. Under such system an increase in a cost or operation expense item will ordinarily be reflected as an increase in the revenue requirement needed to be covered by rates and similarly loss of or a decrease in a credit to an operating expense or cost item also results in an increase in the revenue requirement. (c.f., *Pacific Telephone & Telegraph v. Public Utilities Commission* 62 C.2d 634, 644-45 (1965) and

City and County of San Francisco v. Public Utilities Commission 6 C.3d 119, 122-23 (1971)). Thus, when rates are fixed under an erroneous assumption as to the availability of a revenue or credit item, they produce less revenues than they were designed to produce. It follows that if rates are fixed at the *minimum* level required by law and if such minimum level is based upon an erroneous assumption as to the availability of a revenue or credit item, then the rates will not produce the minimum revenue requirement and they are confiscatory.

In the case at bar, if the experience of Edison proves to be similar to the experience of Southern California Gas Company and Pacific Telephone & Telegraph Company and General Telephone Company, (in that it receives a negative IRS ruling as to its eligibility for the income tax benefits which in Edison's case were assumed by the Commission to be available to Edison in fixing Edison's rates at the minimum level required by law) Edison would incur irreparable damage. This follows because under the proscriptions against retroactive rate making and under the historically established principles of constitutional law the Commission could not in the future properly make the Company whole by increasing future rates higher than they should otherwise be, because of such past losses. Past losses cannot be used to enhance the value of the property or support a claim that rates for the future are confiscatory (*see Galveston Electric Co. v. Galveston* 258 U.S. 388, 395 (1922); *Georgia Railway & Power Company v. Railroad Commission* 262 U.S. 625,

632 (1923); *Pacific Telephone & Telegraph v. Public Utilities Commission* 62 C.2d 634 (1965)).

Nor can the Commission under the constitutional standards prescribed by the United States Supreme Court in the *Hope* and *Bluefield* cases supra, p. 3, properly fix rates which do not provide the utility with an opportunity to earn a return that will avoid continuing dilution of the interests of the common stockholder because the earnings are insufficient to support the sale of new common stock prices at least approximating book value. In a case involving a situation which, in this respect, is substantially on all fours with the case at bar, the Supreme Judicial Court of Massachusetts recognized the constitutional inhibitions upon such action in *New England Telephone Co. v. Department of Public Utilities* 354 N.E.2d, 860, 868 (1976).

2. THE DEMONSTRATED EFFECTS OF THE COMMISSION'S ACTION IN THESE CASES CONSTITUTE A DENIAL OF THE RIGHTS OF EDISON AND ITS SHAREHOLDERS UNDER BOTH THE FEDERAL AND STATE CONSTITUTIONS.[1]

For further demonstration of such denial reference is respectfully made to the analyses in Edison's aforesaid Petitions for Writ of Review and pleadings related thereto which are incorporated herein by reference and to which the Court's attention is respectfully directed.

[1]Non-compliance with the due process clauses of the Fifth and Fourteenth Amendments to the Constitution of the United States and of California Constitution Article I, Section 7, are here involved.

WHEREFORE, Petitioner prays:

That this Honorable Court reconsider its denial of the Petitions for a Writ of Review, grant a rehearing, and defer argument until ruling is issued by the Internal Revenue Service upon the Investment Tax Credit issue.

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WILLIAM E. MARX
DENNIS G. MONGE
/s/ By Rollin E. Woodbury
Attorneys for Petitioner
Southern California Edison Company

Dated: July 6, 1978.

VERIFICATION

I, EDWARD A. MYERS, JR., declare and state that I am a Vice President of Southern California Edison Company, the petitioner in the above-entitled actions, and that I am authorized to and make this declaration for and on behalf of said petitioner. I have read the foregoing petition for rehearing and am informed and believe the matters stated therein to be true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Dated July 6, 1978.

/s/ Edward A. Myers, Jr.
Edward A. Myers, Jr.

APPENDIX 10.

Decision No. 84568

Before the Public Utilities Commission of the State of California.

Investigation on the Commission's own motion regarding the investment credit provisions of the 1975 Tax Reduction Act. Case No. 9915, (Filed May 13, 1975).

John C. Morrissey, Malcolm H. Furbush, and Robert Ohlbach, by *Robert Ohlbach,* Attorney at Law, for Pacific Gas and Electric Company; *John Ormasa,* Attorney at Law, for Southern California Gas Company; Rollin E. Woodbury, William E. Marx, and H. Robert Barnes, by *Rollin E. Woodbury,* Attorney at Law, for Southern California Edison Company; Chickering and Gregory, by *Donald J. Richardson, David A. Lawson,* and *Allan Thompson,* Attorneys at Law, and *Gordon Pearce* and *John Woy,* Attorneys at Law, for San Diego Gas & Electric Company; and Orrick, Harrington, Rowley & Sutcliffe, by *James F. Crafts, Jr.,* Attorney at Law, and *Delwyn C. Williams,* for Continental Telephone Company of California; respondents.

Margaret V. Sheehan, for California Pacific Utilities; Burt Pines, City Attorney, by *Leonard L. Snaider,* Deputy City Attorney, for the City of Los Angeles; *Robert Russell,* for Los Angeles Department of Public Utilities and Transportation; John Witt, City Attorney, by *William Shaffran,* Attorney at Law, for the City of San Diego; *Neal C. Hasbrook,* for California Independent Telephone Association; *J. William Zastrow,* for Utility Commission Rules Committee, California Section, American Water Works Association; *George Gilmour,* Attorney at Law, and *Sylvia M. Siegel,* for Toward Utility Rate Normalization; and Thomas M. O'Connor, City Attorney, by *Robert Laughead,* for the City and County of San Francisco; interested parties.

Timothy E. Treacy, Attorney at Law, *Bruno A. Davis,* and *K. K. Chew,* for the Commission staff.

ORDER DISCONTINUING INVESTIGATION

The Commission not being able to agree on a result in this investigation,

IT IS ORDERED that the investigation is discontinued.

The effective date of this order is the date hereof.

Dated at San Francisco, California this 17th day of June, 1975.

I will file a concurring opinion
which was the original order draft
in this case.
/s/ D. W. HOLMES, Commissioner

I concur with Commissioner Holmes'
opinion.
/s/ LEONARD ROSS, Commissioner

I will file a written concurrence.
/s/ ROBERT BATINOVICH, Commissioner

VERNON L. STURGEON
President
WILLIAM SYMONS, JR.
D. W. HOLMES
LEONARD ROSS
ROBERT BATINOVICH
Commissioners

CERTIFIED AS A TRUE COPY
/s/ William R. Johnson
Secretary
Public Utilities Commission
State of California

Commissioner D. W. Holmes, concurring:

On May 13, 1975 the Commission instituted an investigation on its own motion into the effect of the investment credit provisions of the Tax Reduction Act of 1975 (1975 Act) upon all electric, gas, water, sewer, and communications public utilities under the jurisdiction of this Commission which have heretofore elected to flow through the tax credit generated by the Federal Revenue Act of 1971 (1971 Act).

The 1975 Act increased the investment credit for certain public utilities from 4 percent to 10 percent. This increase is applicable to qualified plant expenditures made after January 21, 1975 and before January 1, 1977 and may result in significant federal income tax savings for the years 1975 and 1976.

The 1971 Act permitted public utilities which flowed through the tax benefits of accelerated depreciation on post-1969 public utility property to flow through the full benefit of the investment credit established by the 1971 Act on such property. (26 USC § 46(e)(3).) Various utilities under the jurisdiction of this Commission made such an election under the provisions of the 1971 Act.

A similar election to flow through the full benefits of the additional credit may be made by such utilities under the 1975 Act; or, alternatively, an election may be made to flow through the credit ratably over the

life of the property. Such elections must be made by the affected public utilities by June 26, 1975. In the event that no election is made, a rate base adjustment of the benefits of the additional credit is applicable for ratemaking purposes.

This investigation is directed toward determining the effect of the 1975 Act on eligible flowthrough utilities and considering what action this Commission may take with respect to the investment credit provisions of the 1975 Act. A prehearing conference was held the morning of May 21, 1975 and a public hearing was held the afternoon of May 21, 1975 in San Francisco before Commissioner D. W. Holmes and Examiner Robert Barnett, and the matter was submitted.

The 1975 Act made significant changes in the treatment of the investment credit; two such changes are: (1) It increased the credit from 4 percent to 10 percent and (2) it placed some restrictions on the ability of certain utilities to flow through the increased credit to ratepayers. The 1975 Act includes Section 46(f)(8) as follows:

> "(8) PROHIBITION OF IMMEDIATE FLOW-THROUGH. An election made under paragraph (3) shall apply only to the amount of the credit allowable under section 38 with respect to public utility property (within the meaning of subsection (a)(6)(D)) determined as if the Tax Reduction Act of 1975 had not been enacted. Any taxpayer who had timely made an election under paragraph (3) may, at his own option and without regard to any requirement imposed by an agency described in subsection (c)(3)(B), elect within 90 days after the date of the enactment of the Tax Reduction Act of 1975 (in such manner as the

Secretary or his delegate shall prescribe) to have the provisions of paragraph (3) apply with respect to the amount of the credit allowable under section 38 with respect to such property which is in excess of the amount determined under the preceding sentence. If such taxpayer does not make such an election, paragraph (1) or (2) (whichever paragraph is applicable without regard to this paragraph) shall apply to such excess credit, except that if neither paragraph (1) or (2) is applicable (without regard to this paragraph), paragraph (1) shall apply unless the taxpayer elects (in such manner as the Secretary or his delegate shall prescribe) within 90 days after the date of the enactment of the Tax Reduction Act of 1975 to have the provisions of paragraph (2) apply. The provisions of this paragraph shall not be applied to disallow such excess credit before the first final determination which is inconsistent with such requirements is made, determined in the same manner as under paragraph (4)."

It is the interpretation of Section 46(f)(8) that was the principal issue involved at the hearing. That section permits a utility which had elected to flow through the investment credit under the 1971 Act to flow through the increased investment credit under the 1975 Act. It also provides that the taxpayer, if it does not so elect, may choose either a ratable flowthrough method or a rate base deduction method of accounting for the investment credit. The statutory language permitting those three options is set forth in Appendix A of this decision. For convenience, we will discuss the options as Option 1—rate base adjustment; Option 2—cost-of-service ratable flowthrough; and Option 3—full flowthrough.

At the outset some utilities expressed fear that merely by holding the hearing the Commission was jeopardizing the election to be made by the utility. They cite the language in Section 46(f)(8) to the effect that "any taxpayer who had timely made an election under paragraph (3) may, at his own option and without regard to any requirement imposed by an agency [such as the Public Utilities Commission] . . . elect within 90 days after the date of the enactment of the Tax Reduction Act of 1975 . . . to have the provisions of paragraph (3) apply with respect to the amount of the credit allowable. . . ." Notwithstanding their fear, four utilities presented evidence concerning their position on the investment credit permitted by the 1975 Act. Pacific Gas and Electric Company (PG&E) has determined to elect Option 3 on a five-year rolling average. The revenue-saving to the ratepayers would be approximately 91 million dollars over the five-year period. Both Southern California Edison (Edison) and Southern California Gas Company (SoCal) have determined to elect Option 2. San Diego Gas & Electric Company (SDG&E) has not yet made a decision but is leaning toward Option 2.

The position of the Utilities Division of the Commission staff is that the Commission should make its preference known for Option 3; the position of the Finance & Accounts Division of the Commission staff indicated that traditionally the Commission, as a matter of policy, has adopted for ratemaking purposes the immediate flowthrough method of treating flowthrough credits. As a practical matter F&A often used a five-year amortization period to level the peaks and valleys that can result from the application of flowthrough. Any change from this method should be made only after a convincing showing by the utilities of their

need for additional cash flow. F&A recommends that the utilities justify their choice of methods, other than the flowthrough method, of treating the investment credit and that the Commission consider allowing the utilities to normalize the investment credit in those cases in which there is a need to increase cash flow. The position of the staff is that the Commission should not order the utilities to make any particular election but that the Commission should now indicate to the utilities how it expects to treat the credit when rates are to be fixed, and that at that time the Commission should determine whether or not the utility has acted imprudently in making its choice. The staff recommended that the Commission should indicate that the prudent choice is Option 3. The city of Los Angeles, the city and county of San Francisco, the city of San Diego, and TURN support the staff position.

The evidence presented at the hearing was brief. Edison presented one witness and an exhibit in support of its position to elect Option 2. The witness testified that Option 2 provides the greatest opportunity under the 1975 Act to increase the internal generation of funds, which in turn reduces the need for external funds, and also improves the before-tax interest coverage calculation. In the face of the severe capital shortage problems being experienced by Edison and the current inflationary period, Edison expects to have difficulty in obtaining needed capital from external sources. The investment credit, to the extent that it is retained by Edison, eases this situation. Other persons who commented on behalf of utilities reiterated this position. Both SoCal and SDG&E made arguments similar to Edison's. Arguments were made in opposition to the utilities' position and the staff introduced an exhibit.

No other evidence was presented. At the conclusion of the hearing the Presiding Examiner announced his and the assigned Commissioner's tentative conclusion to recommend to the Commission that the Commission should declare that it is prudent for eligible utilities to adopt Option 3.

The utilities' position has two aspects: (1) That this Commission should make no statement at all concerning the 1975 Act, for to do so might be considered coercion by the Treasury Department in violation of Section 46(f)(8) of the Act; and (2) if the Commission does express an opinion, it should not state a preference for flowthrough as such a preference would not only be coercive but would also violate the intent of Congress that utilities should benefit from the 1975 Act by retaining the investment credit to provide additional capital for investment.

I reject the idea that we cannot express an opinion concerning the investment credit provisions of the 1975 Act. Certainly we have the right to inform ourselves concerning the nature and interpretation of the statute, and we can think of no better place to obtain such information than at a public hearing where all interested parties of whatever persuasion may come forward and be heard. Even more compelling is our duty to announce our opinion concerning our interpretation of the Act so that those whom we regulate will be given guidance in conducting their affairs. If it comes to our attention that a utility might act imprudently, we should not sit idly by, especially when one of the results of a utility's imprudence would have a detrimental effect on the ratepayers.

The tax accounting election is solely up to the discretion of the utilities. I have no intention to dictate

that election. The case of *Pacific Tel. and Tel. Co. v Public Utilities Commission* (1950) 34 C 2d 822, where the Commission prescribed the terms of a contract between the utility and its affiliate, is a useful guideline. In that case the court reversed the Commission on the ground that the Commission could not prohibit a utility from entering into an imprudent contract but that the proper remedy was to protect the ratepayer by disallowing the effects of the imprudence by proper ratemaking adjustments. (34 C 2d at 830.) The Commission need not, however, sit back and watch a situation develop without indicating that the utility may be making a poor choice. To the extent that the Commission knowingly remains silent in the face of a potentially imprudent act on the part of a utility would, in itself, be an act of imprudence on the part of the Commission.

We must analyze a utility's choice as it pertains to tax options and, if it has acted unfairly against the best interests of the ratepayers, we are compelled to make ratemaking adjustments to protect the ratepayers from management's imprudence. This concept has been frequently emphasized by the Commission and the courts.

> "We freely recognize, as does the Commission, that there are many areas and many situations which must remain within the jurisdiction of management. However, it has long been recognized that the establishment of public utility charges involves the assessment of costs for a public service. Basic to the purpose of the Natural Gas Act is a design of regulation concerned with final adoption of rate charges fairly intended to protect the public interest. Necessarily, the area of tax

> policies embraces managerial decisions directly reflected in the cost of natural gas supplies for the use of the ultimate customer. Here it seems to us quite reasonable and logical to recognize as inherent in the Commission the duty and requirement to exercise its expertise in evaluating the entire tax effect of managerial judgment. If such elected tax policies do not fairly indicate a reasonable and prudent business expense, which the consuming public may reasonably be required to bear, following the required hearing and review procedures, then federal regulatory intervention is required." (*Midwestern Gas Transmission Company v Federal Power Commission* (7 Cir. 1968) 388 F 2d 444, 448.)

> "The establishment of public utility charges involves the assessment of all reasonable costs for a public service, including taxes. In the initial instance, whether for financing, operating expenses or plant composition, most utility costs arise from the exercise of managerial judgments. Generally, when management judgments produce results which are unfair to the ratepayer, regulation steps in." (*P.T.&T. Co.* (1968) 69 CPUC 53, 62.)

> "Income tax expense must be considered by the commission in establishing Pacific's cost of service. [Citing cases.] However, 'the primary purpose of the Public Utilities Act is to insure the public adequate service at reasonable rates without discrimination; and the commission has the power to prevent a utility from passing on to the ratepayers unreasonable costs for materials and services by disallowing expenditures that the commission finds unreasonable.' [Citing cases.]"

> "The same rule applies where the utility resorts to accounting practices which result in unreasonably inflated tax expense." (*City and County of San Francisco v Public Utilities Com.* (1971) 6 C 3d 119, 126.)

The argument that it is the "intent of Congress" that utilities should retain the investment credit deserves short shrift. When a statute is clear on its face, there is no need to determine the intent of Congress when applying the statute. This statute provides for three options, one of which is flowthrough. The utilities are free to choose flowthrough or either of the other two options. To the extent that Congress intended anything, it is certain that it intended that flowthrough be one of the options.

I agree with the recommendation of the Presiding Examiner and assigned Commissioner that it would be prudent for eligible utilities to elect Option 3. I make this statement based upon my reading of the statute, my experience and expertise with the issue of flowthrough versus normalization, with my understanding of the current financial situation of the utilities involved, and with my regard for the rights and interest of the ratepayers. I recognize that the question of imprudence on the part of a particular utility may not arise at all or if it does arise will be in the context of a rate case where all parties may present evidence on the issue of imprudence. I cannot exclude the possibility that on an individual basis there may be some utilites which can show that their choice was not imprudent.

In reaching my recommendation in this case I have considered the arguments of the utilities to the effect

that it would be prudent for them to elect Option 2 because such election would assist the utilities in generating internal cash for plant expansion. For example, Edison asserts that total capital expenditures are currently estimated to be $3.2 billion over the five-year period 1975-1979. This five-year requirement is double the $1.6 billion capital expenditures for the preceding five-year period and will necessitate a substantial amount of external financing. Exclusive of refunding requirements, over 60 percent of such capital expenditures must be obtained from external sources through the issuance of securities. Normalization of the tax credit will reduce the requirement for obtaining external funds. I am also aware that normalization will improve the utilities before-tax interest coverage which, for many utilities, has been dropping. I recognize that improved interest coverage makes external financing easier. And I recognize that many utilities, such as Edison, are selling their common stock at below book value. Financing by means of selling additional common stock would result in a dilution in the value of current stock and would require earnings to support dividends. To the extent that normalization reduces the need for equity financing it will alleviate the effects of the dilution and will add to the utilities' financial strength.

Against the benefits to the utilities that normalization would bring, I have weighed the benefits of flowthrough. Under flowthrough the company simply passes on to ratepayers the benefits it receives in lowered taxes. This is the other side of the theory used by the utilities when they seek a cost of gas increase. If it is reasonable for a utility to pass on an extraordinary increase in expense, such as an increased cost of gas, it is equally reasonable for a utility to pass on an extraordinary

decrease in expense, such as decreased tax. If this was not a decrease in taxes but was a decrease in fuel costs, the tariffs of all of the electric and gas utilities in California would require a reduction in rates.

Whenever it has a choice the Commission has always rejected normalization and chosen flowthrough. This is no more than enforcing the traditional regulatory concepts that utilities have a duty to minimize expenses and that ratepayers shall be charged only for the expenses of the utility and for taxes "as paid". The principle of taxes as paid and the principle that investors supply capital and not ratepayers were most recently recognized in *City and County of San Francisco v PUC* (1971) 6 C 3d 119, 129 where it is stated:

> ". . . it is clear that requiring ratepayers to put up the capital . . . is contrary to the basic principle of utility rate setting. The basic principle is to establish a rate which will permit the utility to recover its cost and expenses plus a reasonable return on the value of property devoted to public use. (Citation omitted.) By permitting Pacific to include in its costs such charge for federal taxes greatly in excess of its actual federal tax expense, the commission is deviating from this basic principle."

Finally, I have considered the practical effect of the consequences of normalization on the ratepayers. For example, in 1975 SoCal will receive $2,060,000 in tax credits. Under Option 3 it could reduce rates to consumers by $4,426,000. Under Option 2 rates would be reduced by only $114,000 and net investment tax credits would be $53,000. The actual tax credit under both methods is $2,060,000. If Option 2 is used,

ratepayers would provide the utility with $4,312,000 more in rates than under Option 3 ($4,426,000 minus $114,000). The utility would, however, have only $2,000,000 more in tax credits ($2,060,000 minus $53,000). Ratepayers would have to provide the utility $4,300,000 in rates to give the utility $2,000,000 in capital. On its face this is a most imprudent means of raising capital.

After weighing the arguments, I feel that it is prudent for eligible utilities to elect Option 3, flowthrough.

This Commission is aware of the problems of the utilities in raising capital and in meeting their expenses. As a result of that awareness we have provided various methods by which utilities may obtain prompt rate relief outside of a general rate case. Those methods include Advice Letter filings, offset relief, and interim relief pending a general rate case. I see no reason to abandon traditional methods of regulation.

Dated at San Francisco, California, this 17th day of June 1975.

/s/ D. W. HOLMES
D. W. Holmes, Commissioner

APPENDIX A

Internal Revenue Code 26 USC § 46

(f) Limitation in case of certain regulated companies.—

(1) General rule.—Except as otherwise provided in this subsection, no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection); or

(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably. If the taxpayer makes an election under this sentence within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, the immediately preceding sentence shall not apply to property described in paragraph (5)(B) if any agency or instrumentality of the United States having jurisdiction for ratemaking purposes with respect to such taxpayer's trade or business referred to in paragraph (5)(B) determines that the natural domestic supply of the product by the taxpayer in the course of such trade or business is insufficient to meet the present and future requirements of the domestic economy.

(2) Special rule for ratable flow-through.—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property de-

scribed in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

(3) Special rule for immediate flow-through in certain cases.—In the case of property to which section 167(I)(2)(C) applies, if the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraphs (1) and (2) shall not apply to such property.

COMMISSIONER BATINOVICH, CONCURRING.

I concur with the determination that it is prudent for eligible utilities to elect the third option—flowthrough. However, I must stress that flowthrough is not necessarily the only prudent election. There are circumstances and conditions under which other elections might also be shown to be prudent.

I regard the tax benefits conferred on the utilities by election of the other options to be "windfall" in nature, and I believe that the benefit from such windfall should be shared by the ratepayers. I suggest that there may be substantial benefits to the ratepayers from other than a relatively slight rate reduction. Specifically, I propose as follows:

The rate base should be permanently reduced by the amount of the increased tax credit (in the same manner that I propose to reduce rate base to reflect the gain from the sinking fund redemption of bonds). The internally generated funds should be applied to the development of technology in the areas of conservation and development of alternative, less costly, energy sources. The May 1975 issue of *Progress,* the PG&E publication, discusses some of the alternative sources of power now being explored, not nuclear or fossil fuel but solid waste, geothermal, tidal, wind, and solar. By allocating substantial capital to the development of these alternatives we may be able to offer the ratepayers the only meaningful long-term benefit—an assured source of energy at a reasonable price. The Commission would appoint a committee that would be delegated the function of coordinating the efforts of the participating utilities and to assure the ratepayers that the dollars being spent, pursuant to this prudent election, were in fact being spent prudently.

Until electric utility companies are given financial incentive to develop new, less costly sources of fuel, I would expect little or no progress and therefore I would propose that the ratepayer and utility share in the savings of alternate fuels from today's present value of the equivalent oil cost pursuant to §456 of the Public Utilities Code.

Since both the shareholder and consumer will benefit from this proposal, the shareholders should participate in the contribution at least to the extent of accepting a self-imposed moratorium on any increases of dividends over present rates until such time as this energy crisis has been resolved. Furthermore, I would consider any increase in the dividend rate to be an imprudent allocation of resources.

In my opinion there will be no meaningful resolution to the energy crisis until electric utility companies have *developed, built* and *are operating* plants using substitute forms of present fuels that have a lower and relatively constant cost and hopefully endless availability.

Dated: June 17, 1975
San Francisco, California

/s/ ROBERT BATINOVICH
Robert Batinovich, Commissioner

APPENDIX 11.

Order Denying Alternative Writ S.F. No. 23605.

In the Supreme Court of the State of California, in Bank.

Southern California Edison Company, petitioner v. Public Utilities Commission, etc., et al.

Filed: June 22, 1978.

Petition for writ of review DENIED.

/s/ Bird
Chief Justice

APPENDIX 11a.

Order Denying Alternative Writ S.F. No. 23723.

In the Supreme Court of the State of California, in Bank.

Southern California Edison Company, Petitioner v. Public Utilities Commission, etc., et al.

Filed: June 22, 1978.

Petition for writ of review DENIED.

/s/ Bird
Chief Justice

APPENDIX 12.

CLERK'S OFFICE, SUPREME COURT
4250 State Building
San Francisco, California 94102

July 19, 1978.

I have this day filed Order REHEARING DENIED.

In re: S.F. No. 23605. S. Calif. Edison Company vs. P.U.C., etc., et al.

Respectfully,

G. E. BISHEL
Clerk

APPENDIX 12a.

CLERK'S OFFICE, SUPREME COURT
4250 State Building
San Francisco, California 94102

July 19, 1978.

I have this day filed Order REHEARING DENIED.

In re: S.F. No. 23723. S. Calif. Edison Co. vs. P.U.C., etc., et al.

Respectfully,

G. E. BISHEL
Clerk

APPENDIX 13.

Ex. 127, Appl. No. 54946.

Southern California Edison Company.

I.R.S. RULING T:C:E:A:3
Southern California Gas Company
CPUC Decision Nos. 85627 and 86117
Before the Public Utilities Commission
Of The
State of California
May 1977

Miller & Chevalier
1700 Penna. Ave., N.W.
Washington, D.C. 20006

Attn: David W. Richmond, Esq.
and
Dennis P. Bedell, Esq.

Re: Rulings Requested;
Southern California Gas Company;
Public Utilities Commission of
the State of California,
Decisions Nos. 85627 and 86117

Gentlemen:

This letter replies to your ruling request dated April 19, 1976, as amended and supplemented thereafter, which was submitted on the behalf of Southern California Gas Company (SoCal). The ruling sought goes to the effect of certain ratemaking decisions and orders issued by the Public Utilities Commission of the State of California (CPUC) on the availability to SoCal of investment tax credit for Federal income tax purposes.

The requested ruling reads as follows:

"(1) The CPUC Decisions Nos. 85627 and 86117, if they become final determinations within the meaning of section 46(f)(4), will not be inconsistent with section 46(f)(2)."

The City Attorney of Los Angeles (City) by letter of May 18, 1976 filed comments on the SoCal ruling request citing the fact that because the City and its residents constitute major markets for SoCal, it has been extremely active in advocating the proper ratemaking treatment of Federal income taxes before the CPUC and the Supreme Court of the State of California (Supreme Court). From this position, the City contends that the consistency of the CPUC decisions with the provisions of section 46(f)(2) is so evident that there is no justifiable reason to even seek a ruling.

On this last point, the City, although in accord with the conclusion and requested ruling, expresses its deep concern that the request is less than a wholehearted effort on the part of SoCal to secure the ruling it requests. Moreover, the City is critical of the omission from the request of relevant background material, the inclusion of irrelevant and extraneous references; and the misleading character of certain refund figures SoCal submits. Additionally, the City stresses that Decision No. 85627 is not final; that it will be relevant for tax purposes only when it becomes final; and that at this juncture, analysis of the CPUC action is premature because the Internal Revenue Code of 1954 (Code) looks to final regulatory determinations made with respect to public utility property to which section 46(f) applies.

Rev. Proc. 72-3 (1972-1, C.B. 698) sets out the conditions under which rulings will issue in advance

of adoption of regulations. In the effort, to bring its request within the provisions of this procedure, SoCal recites that it will suffer unusual hardship from its failure to obtain the requested ruling. Its position is that if Decision No. 85627 is found eventually to contravene the provisions of section 46(f)(2), it will be denied the additional investment tax credit on its qualified public utility property additions for the year 1975, as provided by the Tax Reduction Act of 1975 (1975-1 C.B. 545), and also would be required to refund to its utility customers an amount approximately equal to the additional investment credit that would otherwise be available.

It is clear however, that the hardship of which SoCal speaks is potential in nature and contingent upon the happening, of future events now uncertain. On July 26, 1976, the CPUC issued Decision No. 86154 in which it noted SoCal's Petition for Stay to the Supreme Court, and ordered a suspension of the rate refund requirements imposed on SoCal in Decision No. 85627 (as modified by Decision No. 86117), pending review of those decisions and further order of the Commission. In such circumstances, and as SoCal acknowledges, if the decisions are found to be inconsistent with section 46(f)(2) of the Code and are reversed on appeal, it will not be placed in an economically detrimental position.

The question of hardship, or the absence thereof, aside, it is the practice of the Service to answer inquiries whenever appropriate in the interest of sound tax administration, and to issue rulings pending adoption of regulations when the answer seems clear from an application of the provisions of the statute to the facts described. This is considered to be such a case.

The relevant facts set out in SoCal's request; the stated position of the City in the circumstances and the pertinent information contained in the accompanying materials are summarized as follows:

SoCal, a regulated public utility subject to the jurisdiction of the CPUC, provides natural gas service in the southern California area. The CPUC following hearings convened for the purpose, among others, of determining the effect of the Tax Reduction Act of 1975 (particularly with respect to investment tax credit) on SoCal's revenue requirements, issued its Decision No. 85627 on March 30, 1976. Therein, the CPUC concluded it appropriate and so ordered SoCal to refund to its customers, a gross revenue amount corresponding to a rate of return reduction adjustment of 0.25% on a utility rate base of $824.5 million for the test year 1974. This would amount to a refund of about $4.4 million based on a net revenue reduction caused by the reduced rate of return of $2,061,250.

This refund order in Decision No. 85627 (as later affirmed in Decision No. 86117) is that which prompted SoCal to submit its petition to the Supreme Court following denial of rehearing by the CPUC. The position of the utility in hearing, as noted in Decision No. 85627, and as discussed more fully below, was that under the Code and proposed regulations section 1.46-5(b)(2)(i), the additional investment tax credit to which SoCal would be otherwise entitled would be forfeited if the recommendations of the CPUC Staff and the City as advanced in the proceeding were followed. The parties had charged SoCal's management with imprudence in the utility's election, for ratemaking purposes, to have the special rule under section 46(f)(2) of the Code (relating to ratable cost of service

reduction) apply to the additional credit allowable for its qualified public utility property by reason of the Tax Reduction Act of 1975.

Arguing that SoCal should have elected instead the immediate flow through of the benefits of the additional credit to the ratepayers under section 46(f)(3), the recommendations (Staff and the City) to the CPUC were that the utility, notwithstanding its section 46(f)(2) election, should be either penalized, or its rates should be adjusted in such a manner that the end result would equate to immediate flow-through treatment. The penalty to be imposed on the ground of mangerial imprudence according to the Staff estimates was in the vicinity of $4.0 million to $4.5 million. It was the Staff's position that a penalty for mangerial imprudence does not result in the reduction of tax expense or any other expense normally considered in determining the cost of service of a California utility, nor did the Tax Reduction Act of 1975 bar a penalty for managerial imprudence. Thus, it concluded that no forfeiture would result from such an action by the Commission.

The position of the Staff, as described in Decision No. 85627, was based essentially on the propositions that prudent management required the immediate flow through election under section 46(f)(3) since the ratepayers who actually pay the utility taxes are entitled to reap the benefits of any tax savings available to the utility; that the benefits under the section 46(f)(2) are minimal, whereas the section 46(f)(3) represents the largest reduction in revenue requirements; that the CPUC in the past has adopted the full flow through treatment of investment tax credit whenever possible and all major California utilities have been operating,

with some variations, on that basis; and that SoCal should be penalized to demonstrate that it could not disregard the ratepayer's interest, particularly when it acted with the knowledge that its election under section 46(f)(2) could result in the forfeiture of the additional tax benefits to which the utility customers are entitled.

The City estimated that SoCal should be required to refund a total of $4,981,000 which figure consisted of the revenue requirements generated by the additional investment tax credit claimed for 1975 in the amount of $2,320,000. Its position went to the following points: SoCal's election under section 46(f)(2) results in minimum benefits and maximum rates which are based on tax liabilities not actually incurred; that the imposition of such rates constitutes the impermissible involuntary contribution of capital by the customers; and that ratable flow through of investment credit is, from the ratepayer's standpoint, the most expensive method of raising capital. Further, that failure of the CPUC to find SoCal's management imprudent would not only harm the utility customers, but would reward this imprudence at the expense of other California utilities which had elected immediate full flow through of the credit; and that SoCal seeks to quickly pass through to its customers the increased costs of gas supply, but inconsistently desires to retain the benefits of reduction in tax liability.

SoCal countered with the proposition that its election under section 46(f)(2) was the most prudent course it could follow in that it was more equitable to future ratepayers to flow through the credit ratably so as to benefit the customers over the life of the property which generated the credit. Additionally, SoCal contended that the cash flow generated by the ratable

flow through method under section 46(f)(2) would reduce its external financing requirements and have an actual favorable effect on SoCal's cost of money as well as on its bond ratings and cost of debt and equity capital; that it would not have to raise equivalent funds at high interest rates on the open market; and that sale of its securities would be facilitated and thus result in a lower rate of interest required to be paid by its customers.

The CPUC in the order accompanying Decision No. 85627 did not formally recognize the charge of imprudence on the part of SoCal's management, nor did it sanction the imposition of a penalty in the form of customer refunds. It did, however, see it to be its regulatory duty to consider the effect of SoCal's election under section 46(f)(2) on the risk characteristics of its securities and other financial conditions. Associated with the finding that it has never used the cost of service ratemaking theory as the sole criterion for setting rates, but considers the cost of service as one of many factors in ratemaking, was the finding that the reduction of financial risk claimed by SoCal in its choice of the section 46(f)(2) election would be best recognized by the 0.25% of reduction in the utility rate of return, as cited before.

SoCal, in petitioning the CPUC for rehearing, reconsideration and stay of the refund order in Decision No. 85627, reasserted its claim that the 0.25% rate of return reduction would likely result in forfeiture of the additional investment tax credit otherwise available under the Tax Reform Act of 1975. The CPUC in its Decision No. 86117 (order denying rehearing and modifying Decision No. 85627), again rejected this argument with the following language:

"* * *We disagree. Neither the Tax Reduction Act nor the Regulations suggest that this Commission cannot consider changes in risk in determining a reasonable rate of return. Our decision is in perfect accord with the California Supreme Court's decision in *City of Los Angeles v. Pub. Util. Comm.*, 15 C. 3d 660 (1975)* * *."

And acting on this last-quoted proposition, the CPUC in its Decision No. 86117 modified the previous Decision No. 85627 by the addition of the following conclusion:

"* * * 3. A rate of return adjustment of 0.25 percent is in accord with *City of Los Angeles v. Pub. Util. Comm.*, 15 C. 3d 680 (1975) and will not deprive SoCal of eligibility for the additional investment tax credit under the Tax Reduction Act of 1975 * * *."

The ultimate question to be answered here, therefore, is whether on the assumption that Decisions Nos. 85627 and 86117 were to stand as final determinations within the meaning of the term in section 46(f)(4)(C) of the Code, the circumstances attendant to its order of refund and the effects thereof are such as to contravene the provisions of section 46(f)(2). The question must be answered in the affirmative when the circumstances as presented are considered in the context of the applicable provisions of the statute. This is so for the following reasons.

The clearly stated objectives of the Congress in the reinstatement of the investment credit in respect of public utility property in the Revenue Act of 1971 (1972-1 C.B. 443) were twofold. These were:

(1) to lessen the difficulty many public utilities faced in raising the capital required for modernization and expansion; and (2) to compensate in some measure for the increased competition public utilities were encountering from other regulated and unregulated sectors of industry. *S.Rep. No. 92-437,* 92d Cong., 1st Sess. 36 (1971), 1972-1 C.B. 578. These objectives were carried forward with the provision for the additional credit in the Tax Reduction Act of 1975, cited earlier. This was because in the view of the Congress, public utilities had experienced very considerable difficulty in the intervening years in securing capital for essential expansion due to the depressed state of the stock market, tight money, and the reluctance of regulatory commissions to grant rate increases to cover increased costs. *H.R. Rep. No. 94-19,* 94th Cong., 1st Sess. 12 (1975), 1975-1 C.B. 574.

To further these purposes, there was implanted in section 105 of the Revenue Act of 1971 and section 301 of the Tax Reduction Act of 1975, the broad general principle that no investment credit was to be available in the absence of assurance that some of the tax benefit at least, would go to the utility investors. The only exception to this principle, in the instance of gas distribution companies, was in the limited situation in which a regulated utility had under prior law, as enacted in the Tax Reform Act of 1969 (1969-3 C.B. 10), flowed the benefits of accelerated depreciation through currently to the utility customers.

The foregoing principle was based on the proposition that absent a balancing of the tax benefits as between a utility and its customers, the Congress could find little justification in providing the investment tax credit

allowance, the resultant loss in tax revenues being considered. To permit all of the benefits of the credit to be flowed through to the consumer currently could have had an impact on revenues approximately twice that applicable in other cases.

In the legislative deliberations leading to the passage of the Revenue Act of 1971, careful consideration was given to the impact of the credit on ratemaking decisions. In the resolve to provide for the balancing of the interests of both the investors and customers, and in recognition of the many different ways of treating the credit for ratemaking purposes, a general rule and two basic elective options were made available to public utilities. The particular option exercised would control the manner in which the credit would be treated in the ratemaking process. The general rule relating to the accounting treatment of the additional credit, which provided for the reduction in rate base with a pro rata restoration each year, has no application here; the options as outlined below do apply in the instance of SoCal.

The first option under section 46(e)(2) of the Code, as enacted in the 1971 Act, provided that the credit could be flowed through to income (but not more rapidly than ratably over the useful life of the property), but there could be no adjustment to reduce the rate base. If a company were required by the final determination of a regulatory agency to flow through the credit to income more rapidly than ratably, or if the rate base were adjusted then the utility would lose the otherwise allowable credit for all open years and all future years in which the inconsistent regulatory determination remained in effect.

The second option was available to the limited groups which come within the exception to the general principle as noted before. SoCal qualified for this limited exception. In this status, it made the special election under section 46(e)(3) of the Code, prior to March 10, 1972, that was applicable to all of its public utility property. Accordingly, there was no regulatory limitation on the accounting treatment for ratemaking purposes of the 4 percent credit made available under the 1971 Act, and the benefit could be flowed through currently to the utility customers without resulting in its disallowance.

This election of SoCal accorded with the policy of the CPUC, as noted earlier, by reference to the stated position of the CPUC Staff outlined in Decision No. 85627, "* * * the Commission has previously adopted full flow through the treatment of the ITC in the past whenever possible * * *." But in any event, and the preferences of a regulatory agency notwithstanding, the freedom to exercise the option of its choice was intended to reside exclusively in the utility. This freedom of choice on the part of utilities was not only preserved in the 1975 Act; it was underscored by providing the opportunity to make new elections with respect to the treatment of the additional credit therein provided.

The reason for retention of the options was the legislative concern that the stimulation for the acquisition of productive facilities intended by the increase to 10 percent in the credit allowable with respect to public utility property would be frustrated if any of the benefits were required to be flowed through immediately to consumers in the form of lower rates.

S. Rep. No. 94-36, 94th Cong., 1st Sess. 44 (1975), 1975-1 C.B. 610.

Thus, it was intended that the immediate flow-through of the benefits of the additional credit continue to be the exception rather than the rule. For example, section 46(f)(8) of the Code provides that an election under section 46(f)(3) (relating to immediate flow-through) made before March 10, 1972, with respect to public utility property within the meaning of section 46(a)(6)(D) applies only to so much of the investment credit that would be allowable under section 38 if the 1975 Act had not been enacted. And a utility, as in the case of SoCal, which previously elected to apply section 46(e)(3) (now section 46(f)(3)) to all of its public utility property within the meaning of section 46(f)(5) in order to continue as an immediate flow-through basis was required to elect anew, but at its own option and without regard to any requirement imposed by a regulatory body, to apply section 46(f)(3) to such property. Alternately, and if eligible, it could elect as SoCal did, to apply section 46(f)(2) to such additional credit for property described in section 46(a)(6)(D). If a utility did not make a new election, the general rule under section 46(f)(1) is to apply to additional credit for limited property.

Therefore, and by reason of SoCal's election under section 46(f)(2), the additional investment credit is not to be available with respect to any of SoCal's limited public utility property, if the credit to which it would otherwise be entitled is flowed through to income faster than ratably over the useful life of the property, nor can there be any adjustment to reduce the utility rate base. Limited public utility property

is property described in section 46(c)(3)(B) to which section 167(l)(2)(C) applies, other than nonregulated communication property described in the last sentence of section 46(c)(3)(B).

To test whether or to what extent the credit has been flowed through to income, reference is to be made to any accounting treatment that can affect cost of service. One usual method of flowing through the investment credit is to reduce the amount of Federal income tax taken into account. Another method is to reduce by the amount of the credit, the depreciable basis of the property on the regulated books of account. But the fact that the CPUC in its refund order did not, as the City of Los Angeles contends, require any reduction in either SoCal's cost of service or in its rate base does not mean that its action when viewed in the proper perspective was consistent with the required treatment of the investment credit for ratemaking purposes.

To the contrary, there is every indication that the "reduction in risk" adjustment required by Decision No. 85627 (affirmed by Decision No. 86117) is an impermissible accounting treatment of the credit that affects cost of service. The gross revenue adjustment resulting from the rate of return adjustment of 0.25% places SoCal in a position similar to the position SoCal would have been in had SoCal elected full flow-through for the additional credit. Further, there is no support in the decisions of the rate making proceeding that the "reduction in risk" adjustment of 0.25% bears any reasonable relationship to SoCal's more favorable position for attracting debt and equity financing. The decisions, together, indicate that CPUC did indirectly,

and by another name, what it could not do directly without causing SoCal to lose the benefits of the investment credit. Congress did not intend to allow the investment credit in such circumstances.

Nothing here is meant to suggest that CPUC in its regulatory capacity cannot consider changes in risk in determining a reasonable utility rate of return. The conclusion here is simply that the investment tax credit will not be available for Federal income tax purposes when the benefits to be otherwise derived therefrom such as increased cash flow, increased interest coverage and relieved financial requirements, are treated for rate making purposes in the manner provided in Decision No. 85627 (as affirmed by Decision No. 86117).

Very truly yours,
/s/ John W. Holt
Director, Corporation
Tax Division

APPENDIX 14.

Ex. 126, Appl. No. 54946.

Southern California Edison Company
I.R.S. Information Letter
City of Dallas

Before The Public Utilities Commission
Of The
State of California

May 1977

Department of Public Utilities
City of Dallas, Texas
500 South Ervay
Dallas, Texas 75201

Attn: Mr. Thomas E. Taylor
Director

Dear Mr. Taylor:

This responds to your March 24, 1976 letter request with related memoranda filed on behalf of the City of Dallas for a ruling on a tax issue arising under section 46 of the Internal Revenue Code of 1954. The issue which involves the proper accounting treatment for investment tax credit under section 46(f) of the Code (redesignated from section 46(c) by the Tax Reduction Act of 1975) is presently pending in a current regulatory proceeding. The proceeding was convened by the City for the purpose of fixing the rates and services of Dallas Power & Light Company, the locally franchised public utility.

We regret that a ruling cannot be issued as requested because it is the general practice of the Service to rule only under the procedures set out in Rev. Proc.

72-3, 1972-1 C.B. 698. However, when appropriate and in the interest of sound tax administration, the Service will provide an information letter in answer to inquiries of individuals and organizations as to the tax effects of their acts or transactions. An information letter does not more than call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. This response is considered to be such a letter.

The question posed is whether in the circumstances presented, the availability of the investment tax credit applicable to qualified investment property of the utility under section 46(f) of the Code would be jeopardized if, by a ratemaking order, the benefits of the credit were required to be divided equally between the utility ratepayers and stockholders. That is, based upon a 7 percent rate of return on utility rate base, what the tax consequences would be if a rate order were to require that one-half, or 3½ percent, of the authorized rate of return be flowed-through to income for the benefit of the Company's ratepayers.

It is understood that the Company is a "regulated public utility" as defined in section 7701(a)(33) of the Code; that its holds "public utility property" within the meaning of the term in section 46(c)(3) of the code; that the property qualifies for investment tax credit under the provisions of section 1.46-3(g) of the regulations; and that effective in March 1972, the utility exercised a proper and timely election as provided by section 46(f)(2) (formerly 46(e)(2)) as to the preferred accounting treatment of the credit for ratemaking purposes. The effect of this election for investment tax credit purposes is noted at a later part in this letter.

It is further understood that the City Attorney's position is that the Company's present accounting treatment of the credit does not result in an equitable apportionment of the benefits between the utility shareholders and consumers as required by State statute. The bases for the position are that the consumers' rates include amounts for payment of income taxes that in fact do not have to be paid; that the Company has interest-free use of this money for a long period of time, up to 33-years; and that during this period, the ratepayers are not only denied the use of this money, but they must pay a rate of return on it, as well, if it is invested in property value.

Therefore, the City Attorney proposes that one-half or the authorized rate of return on the amount of the credit be flowed-through as income for the benefit of the ratepayers.

The Company maintains to the contrary that it is currently passing through to its customers the tax savings generated by the credit to the maximum extent permitted by section 46(f) of the Code, consistent with its election under section 46(f)(2) of the Code; and that the City Attorney's proposal contravenes the requirements imposed by the Code section cited. The grounds for this position are that the proposal would require that the benefits of the credit be flowed-through to the customers at a rate more than twice as fast as ratably; or if the credit were to be actually flowed-through no more rapidly than ratably, the effect would be an unlawful exclusion of one-half of the amount in the utility rate base attributable to the credit.

Accordingly, the Company contends that should the proposal be adopted by the City, the result would

be the loss of the credit to both the Company and its customers.

The Company position in the circumstances and to the extent noted below appears to reflect a correct interpretation of the provisions of section 46(f) of the Code. The Congress in enacting section 105 of the Revenue Act of 1971 and section 301 of the Tax Reduction Act of 1975, endeavored to provide for a balancing of the tax credit benefits between a regulated utility and its customers. This was considered advisable because if the total tax benefits of the credit were to be flowed-through currently to the customers, the intended purpose of the credit, i.e., providing an incentive to invest in the modernization and expansion of utility plant, would not be served.

Moreover, if the entire benefits of the credit were to be passed on to the customers, the resulting loss in tax revenue would be double that expected to occur otherwise. Thus, Congress could find little justification in providing for the investment tax credit allowance absent a balancing of the benefits as between a utility and its customers. Accordingly, in both of the foregoing Acts, certain limitations were imposed, as reflected in sections 46(e) and 46(f) of the Code, to provide assurance that regulated companies would retain at least a portion of the benefits of the credit allowance.

The limitations were contained in certain options made available to regulated utilities, one of the options being that exercised by the Company as noted in the forepart of this letter. This option provided that the credit would be available to a utility on qualified investment if the benefits were not flowed-through to income faster than ratably over the useful life of the property, and further, if there was no reduction in

rate base by reason of the credit. If both of these conditions were not met, the credit was not to be available. In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect the utility's permitted profit on investment by treating the credit in any way other than as though it had been contributed by the Company's common shareholders.

Stated differently, if a regulatory agency by final determination required flow-through of the credit at a rate faster than permitted under the option, or if there was any adjustment to the rate base, the utility would not be allowed investment credit for that period and for any taxable periods that are open at the time the limitations of the option are exceeded by the agency. This would be the result if the City Attorney's proposal were to be adopted. But the recognition by the agency of the limitations does not mean that the exercise of the option denies the benefits of the credit to utility customers. While a utility would be permitted to earn a return on the unamortized investment credit, the amortization of the credit reflected in the utility's cost of service would result in increased income for ratemaking purposes with a corresponding benefit to customers in the form of reduced utility rates.

Very truly yours
/s/ John A. Brois
John A. Brois
Chief, Engineering and
Valuation Branch

Enclosure
Rev. Proc. 72-3

APPENDIX 15.

Ex. 127, Appl. No. 54946.

Southern California Edison Company.

I.R.S. Information Letter
Public Service Commission of New Mexico

Before The Public Utilities Commission
Of The
State of California

May 1977

The circumstances are understood to be these. The Company is a "regulated public utility" as defined in section 7701(a)(33) of the Code; it holds "public utility property" within the meaning of section 46(c)(3) of the Code; certain of the property qualifies for the investment tax credit under the provisions of section 1.46-3(g) of the regulations; and the Company exercised a proper and timely election as provided by section 46(e)(2) (now section 46(f)(2)) of the Code as to the preferred accounting treatment of the credit for ratemaking purposes. The effect of this election from the standpoint of investment tax credit availability is noted in the discussion of the basic question set out in the later part.

It is further understood that in the rate proceeding before the Commission, the Company proposed that for ratemaking purposes, the reserve for accumulated deferred investment tax credit be included with the common stock in the derivation of the Company's composite capital structure for use by the Commission in the determination of an overall rate of return to be applied to the utility rate base. Because the Commis-

sion does not contemplate any direct adjustment to the utility rate base, the inquiry centers on the question of whether or not the Company's proposal should be accepted as proper in order that the availability of the investment credit not be jeopardized.

The inquiry is answered in affirmative based upon the effect of the Company's election under section 46(f)(2) of the Code. Upon the exercise of this option, the investment credit is not to be available to a utility with respect to any of its otherwise qualified public utility property if: (a) there is any adjustment to reduce the rate base; or (b) if the credit to which it would otherwise be entitled is flowed through to income faster than ratably in the period of time over which depreciation expense is computed on the utility's regulated books of account.

In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect a utility's permitted return on investment by treating the credit in any way other than as though it had been contributed by the utility's common shareholders. This means that the cost of capital rate assigned to the credit cannot be less than the rate assigned to the common shareholders' investment. If a lesser rate were to be so assigned, it would be treated as, in effect, a rate base adjustment and the credit would be unavailable.

Accordingly, in determining the overall cost of capital of a utility for ratemaking purposes, deferred investment tax credits are properly to be included and assigned a rate not less than that considered applicable to common equity. It follows that the unamortized investment

credit, or that portion of the credit which has not yet been flowed through to income is appropriately to be included in the total capital of a utility on which a rate of return is to be allowed.

This procedure implements the intent of the Congress that the benefits of the credit be shared between investors and customers. While a utility would be permitted to earn a return on the unamortized investment credit, the ratable amortization of the credit reflected in the utility's cost of service would result in increased revenue for ratemaking purposes with a corresponding reduction in the utility's rates.

Very truly yours,
/s/ Geoffrey J. Taylor
Geoffrey J. Taylor
Acting Chief, Engineering and
Valuation Branch

Enclosure

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1978

No. 78-646

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
ROBERT BATINOVICH, WILLIAM SYMONS, JR.,
VERNON L. STURGEON, LEONARD ROSS,
and RICHARD D. GRAVELLE,
the Members of and constituting said
Public Utilities Commission,
Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
ROBERT BATINOVICH, WILLIAM SYMONS, JR.,
VERNON L. STURGEON, CLAIRE T. DEDRICK,
and RICHARD D. GRAVELLE,
the Members of and constituting said
Public Utilities Commission,
Appellees.

**On Appeal from the Supreme Court
of the State of California**

MOTION TO DISMISS OR AFFIRM

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SUBJECT INDEX

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In the Supreme Court

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SOUTHERN CALIFORNIA EDISON COMPANY,
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and RICHARD D. GRAVELLE,
the Members of and constituting said
Public Utilities Commission,
Appellees.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS OR AFFIRM

The Appellees (the Commission) move the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of the State of California,

on the grounds that the appeal does not present a substantial federal question and is not ripe for review.

I
OPINIONS BELOW

The opinions below are correctly stated in Appellant's (Edison's) Jurisdictional Statement.[1]

II
JURISDICTION

Jurisdiction is asserted by Edison under Title 28, United States Code § 1257(2). (Jur. St. 3).

III
QUESTION PRESENTED

Does the Commission's action in adopting 8.80% as a fair and reasonable rate of return for Edison, constitute an abuse of discretion because it sets confiscatory rates, thus depriving Edison of its property without due process of law in violation of the 14th Amendment of the United States Constitution?

IV
ARGUMENT

A. Edison Has Misstated the Question Presented By This Case.

Edison asserts that two federal questions are presented, to wit: (1) whether certain United States Supreme Court decisions, referred to by the Commission, preclude a

[1]References herein to appendices are to those attached to the Jurisdictional Statement. "Jur. St." followed by a number refers to pages of the text of the Jurisdictional Statement.

state regulatory agency from adopting an allowed rate of return at a level higher than the minimum to avoid confiscation; and (2) whether a state regulatory agency, having set rates designed to produce the minimum revenue (return) required by law, and in so doing having allegedly arbitrarily and unjustly disregarded certain costs, and unreasonably assumed the existence of a federal tax credit, has violated Edison's rights under the Fourteenth Amendment to the United States Constitution by depriving it of its property without due process.

By stating the questions in the above manner, Edison seeks to have this Court substitute its judgment for that of the Commission regarding calculation of a just and reasonable rate of return for Edison. This is clearly a role which this Court has declined to play. In suits involving the validity of rates fixed by a state commission, this Court will not sit as a board of revision, but will concern itself only with the question of whether constitutional rights have been violated. *Railroad Commission v. Pacific Gas & Electric Co.*, 1938, 302 U.S. 388, 393; *Los Angeles Gas & Electric Co. v. Railroad Commission*, 1933, 289 U.S. 287, 304, 305. The only question present in this case is whether in the exercise of its rate-making authority, this Commission abused its discretion in such a way as to set confiscatory rates for Edison, thus depriving it of property without due process. If the Commission did not abuse its discretion in setting rates, no federal question remains to be answered.

B. Edison Has Not Sustained Its Burden of Proving that the Commission Adopted a Confiscatory Rate of Return.

It is well settled that a decision of a state commission setting rates and adopting a rate of return for a public utility, which decision has been upheld by the highest court of the state, is presumed to be valid. A utility protesting such a decision has a heavy burden of making a convincing showing that the decision is invalid because it is unreasonable and unjust. *Federal Power Commission v. Hope Natural Gas Company*, 1944, 320 U.S. 591, 602; *Railroad Commission v. Pacific Gas & Electric Company, supra*, at 401. Edison has completely failed to make this showing.

1. Edison Erroneously Alleges that the Commission Has Misconstrued the Standards Set Forth by the United States Supreme Court for Determining an Adequate Rate.

Edison contends that the Commission misinterpreted this Court's guidelines in *Federal Power Commission v. Hope Natural Gas Company, supra*, at 605, and *Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Commission*, 1923, 262 U.S. 679, 692-693, in adopting a fair and reasonable rate of return. (Jur. St. 3, 13). Edison asserts that the Commission, in adopting a rate of return which satisfied the minimum which is required by law, did so because it believed it was precluded by the *Hope* and *Bluefield* decisions, *supra*, from setting a higher rate.

This interpretation cannot be read into the Commission's decision. Decision No. 86794 merely recites the requirements of these decisions and indicates that they are the

minimum required by law. (Appx. 1, p. 5). The Commission nowhere asserts that it believes the *Hope* and *Bluefield* decisions, *supra*, have precluded it from considering anything but the minimum rate of return. Edison recognizes that this minimum level is constitutionally permissible. (Jur. St., 13-14).

In the *Bluefield* case, *supra*, at page 692, this Court stated that as a measure of fairness and reasonableness a utility is entitled to earn a return "... equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties ...;" furthermore, *Hope, supra*, makes clear that ". . . under the standard of 'just and reasonable' it is the result reached not the method employed which is controlling." (*Id.*, page 603). While the rate of return must fall within a zone of reasonableness, it is within the Commission's discretion to choose a rate of return within this zone which in its judgment best protects both the ratepayers and the utility. It is not unreasonable for the Commission to have adopted the lowest rate of return which would satisfy the *Hope* and *Bluefield* standards. The fact that this rate is lower than what Edison would have wished does not raise a constitutional issue.

2. The Commission Properly Considered Edison's ITC Benefits as a Factor in Adopting a Fair and Reasonable Rate of Return.

Edison argues that the Commission based its decision in part on the decrease in financial risk resulting from Edison's election of ratable flow-through treatment of its

investment tax credit (ITC). According to this argument, the Commission erroneously assumed that Edison would continue to be eligible for ITC under the IRS regulations. Because of this error, Edison contends, a rate of return was adopted which cannot produce even the minimum constitutionally permitted revenue (Jur. St. 22).

Edison's assertion that the Commission's action will cause it to lose its ITC eligibility is based on its misunderstanding of the role that ITC played in the Commission's decision to adopt a rate of return of 8.80%. The Commission did not set a rate of return and subsequently adjust it downward by some certain but unstated amount representing ITC. Rather, the Commission considered a host of relevant factors, as it always does when, in a general rate case, it adopts a rate of return for a new test year. (Decision No. 87828, Appx. 2, pp. 125, 133-135). In addition, in adopting the rate of return, the Commission considered all of the available evidence relative to Edison's ITC eligibility and to the proper treatment of its ITC benefits. (See Decision No. 87828, Appx. 2, pp. 114-143).

Edison further contends that if it receives a letter from the IRS to the effect that the Commission's action will render it ineligible for the ITC benefits, Edison will be irreparably harmed because the prohibition against retroactive ratemaking would prevent the Commission from making Edison whole.

Edison's speculative claim of irreparable damage, based on the contingency of some future administrative action, is clearly premature and is not ripe for review by this Court. *Federal Power Commission v. Hope Natural Gas Company, supra,* at 619. Edison has not received a

letter ruling from the IRS, and may not rely on rulings applying only to other taxpayers. (Tax Reform Act of 1976, 26 U.S.C. § 6110(j)(3)). Even if it had received its own letter ruling, this would merely constitute tax planning advice. It could not be construed as a binding statement of the law, nor would it necessarily result in the assessment of any tax liability. The Commission exhaustively reviewed all the evidence put forth by all parties on the matter of ITC. Its conclusion on the facts of this case was based on a knowledgeable and thorough review of prior IRS letter rulings, relevant statutes and regulations, and guidance from the California Supreme Court.

Edison cites *New England Telephone & Telegraph Co. v. Public Utilities Commission,* Slip Op., pp. 12-36 (Maine S. Ct., June 28, 1978) Division No. 752, CCH Utilities Law Reports—State, 7-31-78, par. 22596.03, as support for its contention that a state commission may not fix rates in a manner jeopardizing a utility's eligibility for certain tax benefits. The state commission there calculated rates on the basis of accelerated depreciation with flow-through while at the same time ordering the utility to keep its books using accelerated depreciation without flow-through. The state court found this to be arbitrary, as well as directly contrary to Congressional economic policy. The court also found that such treatment created "a reasonable likelihood" that the utility would lose its ability to take accelerated depreciation, although the basis for this finding was not discussed. In Edison's case, unlike that in *New England, supra,* no different treatment of ITC for accounting and ratemaking purposes exists. Moreover, the Commission specifically reviewed Congressional committee re-

ports and proposed federal regulations in order to ensure that its decision would not conflict with federal policy. Thus it cannot be maintained that the Commission has acted in an arbitrary manner. The *New England* decision, *supra*, is clearly distinguishable on its facts.

3. The Commission Did Not Abridge Edison's Due Process Rights in Deciding Rate Base and Rate of Return Questions.

Edison alleges that three other aspects of the Commission's decision make the rates set therein confiscatory. First, Edison argues that the Commission made no adjustment for the fact that the new rates would not be effective until after the end of the test year. Therefore, Edison argues, because of earnings attrition due to inflation, Edison cannot possibly earn the minimum rate of return which the Commission deemed to be required by law. (Jur. St. 24). Edison also contends that the Commission denied it due process by failing to include in rate base certain plant additions which are characterized as not increasing Edison's system capacity. (Jur. St. 24). Lastly, Edison argues that the Commission violated the standards of the *Hope* and *Bluefield* cases, *supra*, by fixing rates which will prevent Edison from issuing new shares of common stock at a price approximating book value. (Jur. St. 25).

Edison misstates the facts with regard to its first two contentions. The record shows that the rate of return adopted for Edison (8.80%) was near the high end of a range between 8.60 percent and 8.90 percent recommended by a Commission staff expert witness as being fair, reasonable, and including consideration of inflationary pressures.

Concerning plant additions and rate base, the Commission followed its historic method of including these additions in rate base on a weighted average basis, reflecting those portions that did go into operation prior to the end of the test year. Moreover, Edison fails to substantiate its claims of confiscation in its first and second arguments.

As to its third contention, based on an alleged violation of the standards set by the *Hope* and *Bluefield* decisions, *supra*, Edison presents no specific references to these cases. Neither case contains any support for Edison's claim; in fact, language in the *Hope* decision, cited earlier, clearly contemplates a balancing of consumer and investor interests.

New England Telephone & Telegraph Co. v. Department of Public Utilities, Mass. 1976, 354 N.E.2d 860, cited by Edison as being "substantially on all fours" with the instant case, made no attempt to follow *Hope* and *Bluefield*. Indeed, the Massachusetts court gave no authority other than its own decisions to support its holding that a rate which will allow future stock sales to occur only below book value constitutes "... forced dilution which is confiscation, at least in absence of some explanation not present in this case." (*Id.* at p. 867). This case is clearly inconsistent with *Hope*, *supra*, wherein this Court also stated that:

> "Thus we stated in the *Natural Gas Pipeline Company* case that regulation does not insure that the business shall produce net revenues." (*Hope*, *supra*, at p. 603).

The Commission's decisions set out in exhaustive detail the factual and legal bases for its conclusions on rate base and rate of return. In addition to being consistent with

Hope and *Bluefield*, the Commission's decisions fully comport with the requirements placed on it by the California Supreme Court. (See *City of Los Angeles v. Public Utilities Commission*, 1972, 7 C. 3d 331.) Edison's attempts to show that its due process rights were violated amount to no more than dissatisfaction with a balancing process which weighs consumer, as well as investor, interests. Such dissatisfaction presents no federal question.

V
CONCLUSION

For the foregoing reasons, the appeal filed by Edison presents no question warranting review of the decision below, and should be denied. Alternatively, the judgment below should be affirmed.

Dated, San Francisco, California
November 14, 1978.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1978
No. 78-646

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,
vs.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,
Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,
Appellant,
vs.
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,
Appellees.

On Appeal From the Supreme Court of the State of California.

Appellant's Reply Brief in Opposition to Motion to Dismiss or Affirm.

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SUBJECT INDEX

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On Appeal From the Supreme Court of the State of California.

Appellant's Reply Brief in Opposition to Motion to Dismiss or Affirm.

Appellant herewith files its Reply Brief to point out substantive errors in the Motion to Dismiss or Affirm (hereinafter referred to as "Motion") filed on behalf of the Appellees which render such Motion defective and without merit.

A. Refutation of Argument in Motion Relating to the First Question Presented in the Jurisdictional Statement.[1]

1. Appellees assert, at page 4 of the Motion, that an interpretation of the Commission's decision (that the Commission was construing this Court's decisions as precluding the Commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation) cannot be read into the Decision (Decision No. 86794). In refutation, Appellant points out that the Commission stated in said Decision (Appendix p. 5) that the United States Supreme Court "has broadly *defined the revenue requirements* of utility companies *as being the minimum* amount" (emphasis added) which will enable the Company to meet the *Hope* and *Bluefield* tests.[2] Defining "the revenue requirements" as being "the minimum amount" indicates that authorized revenue requirements cannot be something more and constitutes more than "merely reciting" the constitutional requirements of those decisions. Furthermore, this issue was duly raised in Edison's petition for rehearing before the Commission dated January 7, 1977 (Appendix p. 149) and the Commission neither granted rehearing on the issue, nor corrected, nor clarified its decision, nor denied that it had felt itself legally required to fix utility rates at such minimum nor denied that it had applied such improper standard.

2. Although elsewhere (Motion p. 8), Appellees assert that the rate of return adopted by the Commission for Edison, was near the high end of a range recommended by a Commission staff witness,[3] they nowhere deny (nor could they because it is indisputable) that the Commission authorized only what it determined to be "the minimum needed" by the Company (see Juris. Statement, p. 4; Dec. No. 86794, p. 23; Appendix p. 21).

3. Appellees assert (Motion p. 6) that "the Commission considered a host of relevant factors, as it always does when, in a general rate case, it adopts a rate of return for a new test year." Consideration of a host of factors, no matter how multitudinous, obviously does not cure the application of an improper legal standard to those factors.

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[1]Question "1. Do decisions of the United States Supreme Court, including *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Company v. West Virginia Public Service Commission,* 262 U.S. 679 (1923), which were relied upon by the Commission, *preclude* a state regulatory commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation?" (See p. 5 of Jurisdictional Statement and pp. 2 and 3 of Motion.)

[2]Citing: *Federal Power Commission v. Hope Natural Gas Company* (1944) 320 U.S. 591, 605, 88 L.ed. 333, 346; *Bluefield Waterworks and Improvement Co. v. West Virginia P.S.C.* (1923) 262 U.S. 679, 692, 693; 67 L.ed. at 1176.

[3]Notwithstanding the testimony of expert witnesses appearing on behalf of other participants in the proceeding supporting much higher rates of return.

B. Refutation of Argument in Motion Relating to the Second Separate Question Presented in the Jurisdictional Statement.[4]

1. It is indisputable that in this ratemaking case the Commission authorized a rate of return which it determined to be the *minimum* needed by the Company and that, in so doing, it *assumed* the continued availability of the increase in the ITC benefits provided by the Tax Reduction Act of 1975 (see Juris. Statement, pp. 9 and 10), *despite* its awareness, from the evidence before it,[5] of contrary views of the IRS as to the requirements under the federal tax laws for continued ITC eligibility (Appendix pp. 282, 296, and 301).
2. With respect to Edison's contention that it will incur irreparable damage, if its experience proves similar to that of the other California utilities[6] and it receives an adverse ruling as to the continued eligibility in response to its request to the IRS, Appellees assert that such claim is premature (Motion p. 6). Such assertion is specious and reflective of the unlawful arbitrary actions of the Commission and should be taken with a grain of salt in view of the following:

(a) Appellees do not deny that loss of the tax credits which would result would effectively deny Edison any opportunity to earn, from the rates authorized, the return determined by the Commission to be the minimum required, and that such loss could not be utilized to support a later claim, in a subsequent rate proceeding, that rates for the future were confiscatory (see p. 22 of Jurisdictional Statement and cases cited therein).

(b) The Commission has not sought any determination from the IRS as to whether its ratemaking treatment meets federal requirements for continued eligibility, and it has declined to join in any such request by others.

(c) The Commission has refused to provide interim safeguards pending an IRS ruling.

(d) The Commission is well aware that, in the absence of a ruling by this Court in this case, the ultimate determination will be made subsequent to the tax audits by the IRS in later proceedings, in which the Commission could not be required to be a party, and that Appellant, if such tax credits are disallowed, would be compelled

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[4]Question "2. Whether a state regulatory commission, which has ordered utility rates designed to produce only the minimum revenue (return) required by law and which, in so doing, has arbitrarily and unjustly disregarded certain costs and assumed, contrary to existing federal precedential rulings, the existence of a tax credit (without which the rates would produce less than the minimum return required by law), has violated the rights of the utility and its shareholders under the federal constitution by depriving them of property without due process of law and by denying an opportunity to earn a reasonable return. (U.S. Const. amend. XIV.)" (See pp. 5 and 6 of Jurisdictional Statement.)

[5]Ex. 125, Appendix p. 282; Ex. 126, Appendix p. 296; Ex. 127, Appendix p. 301.

[6]As pointed out in the Jurisdictional Statement, since the close of the record in this case, we are advised that adverse rulings have been issued by the IRS in four more rulings involving California telephone utilities (two relating to ITC and two to accelerated depreciation (see Docket Nos. 78-606 and 78-607, App. D, pp. 95A and 116A and App. 3, p. 133a)).

to pay out substantial sums which it could not thereafter recover from its ratepayers.

(e) The Commission is well aware that once its Decision becomes a "final determination" within the meaning of the Internal Revenue Code, any curative action by the Commission would be foreclosed with respect to years to which the commission decision applied under the provisions of Internal Revenue Code Section 46(f)(4).

(f) The Commission is well aware of the existence of conflicting views between the IRS and the Commission as to what rate actions may be taken by it under the federal tax laws without jeopardizing eligibility for ITC benefits, and, by its aforesaid actions and Decisions from which this appeal is taken, the Commission has arbitrarily and unlawfully put Appellant in a position of substantial jeopardy. (*Cf. New England Telephone & Telegraph Company v. P.U.C.*, June 28, 1978, CCH Utilities Law Reports-State 7-31-78, Par. 22596.03 cited p. 23, Jurisdictional Statement.)

Under the circumstances, it is respectfully submitted, the Commission's actions, placing the utility in such jeopardy, are manifestly "an exercise of arbitrary power at variance with 'the rudiments of fair play' . . . long known to our law." *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (1935) 294 U.S. 63, 71.

3. The Commission appears to confuse Edison's contention that, under the decisions of this Court, the United States Constitution requires

that rates be fixed to afford it the *opportunity* to earn a non-confiscatory return,[7] with a claim which Edison does *not* make, *i.e.*, that its rates must be set so as to insure or guarantee it a specified return (see Motion p. 9).

(a) It is, we submit, manifestly clear that where the Commission recognized that the record indicated that a return on common equity of at least 13.28% would be required to raise market price to book value, the allowance of only 12.63% denies it the *opportunity* to earn a fair return[8] which would avoid dilution of the existing ownership interests of present shareholders in the enterprise. *Cf. New England Telephone & Telegraph Co. v. Department of Public Utilities*, 354 N.E.2d 860, 16 PUR 4th 346 (Mass. 1976) cited at pp. 14 and 15 of Jurisdictional Statement.[9]

[7]Such distinction has long been recognized by this Court; as stated by Mr. Justice Brandeis: "The thing devoted by the investor to public use is . . . capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return." See: *Missouri ex rel. SW Bell T. Co. v. Public Service Comm.* (1922) 262 U.S. 276, 290; 67 L.ed 981, 986. *Federal Power Commission v. Natural Gas Pipeline Co.*, (1942) 315 U.S. 575, 590; *Smyth v. Ames*, 169 U.S. 467, 544-5; *Bluefield W.W. & Improv. Co. v. Pub. Serv. Comm.*, (1923) 262 U.S. 679, 692-4; *FPC v. Hope Natural Gas Co.*, (1944) 320 U.S. 591, 602-4. Also see *New England Tel. & Tel. Co. v. Mass. Dept. of Pub. Util.* (1976) 354 N.E. 2d 860, 864; 16 PUR 4th 346, 349-50.

[8]See Decision No. 86794, pp. 20 and 23; Appendix pp. 19 and 21.

[9]In their Motion Appellees assert that the Supreme Judicial Court of Massachusetts in the *New England Telephone* case is inconsistent with the *Hope* case and "gave no authority

(This footnote is continued on next page)

(b) It is, we submit, equally clear that when increased rates, fixed on the basis of a test year cost of service, including the minimum required return, are not made effective until the end of such year, with no adjustment for such delay, the utility is denied any *opportunity* to earn a fair return, and such a rate order deprives the utility of its property without due process of law in violation of the XIV Amendment to the U.S. Constitution.

Conclusion.

Considering the importance of the establishment of uniform interpretations of the federal tax laws and the magnitude of the amounts in jeopardy, as well as the equities of the matter and the constitutional rights involved in the fixing of just and reasonable utility rates, we respectfully submit that the conflicting views of the IRS and the state regulatory commission concerning the proper interpretation of the federal tax laws creates as significant a need for the exercise by this Court of its jurisdiction to review the matter as would a conflict between two federal circuit courts on such important matters. A decision having such far reaching impact as this case upon regulated public utilities—a vital sector of the Nation's economy—calls for review by this Court. We urge the Court to exercise its jurisdiction to review this case.

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other than its own decision in support of its holding" (Motion p. 9). This is something of a retreat from their assertion before the California Supreme Court that such *New England* decision "does not even make a pretense of following the *Hope* and *Bluefield* decisions" (Appendix p. 237). The response made at that time is equally applicable here: "While it is true that the Massachusetts Supreme Court in that decision cited only the Massachusetts Supreme Court cases, a number of those other Massachusetts cases did cite the *Hope* and *Bluefield* decisions and applied the ratemaking principles established by them." (Appendix pp. 237 and 238 and footnote 1).

Respectfully submitted,

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